

State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

March 12, 2009

TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY
2009 MAR 12 PM 2:37
CHIEF CLERKS OFFICE

Les Trobman, General Counsel
Texas Commission on Environmental Quality
PO Box 13087
Austin Texas 78711-3087

Re: SOAH Docket No. 582-08-1719; TCEQ Docket No. 2008-0164-UCR;
Rate/Tariff Change Application of HHJ, Inc., d/b/a Decker Utilities

Dear Mr. Trobman:

The above-referenced matter will be considered by the Texas Commission on Environmental Quality on a date and time to be determined by the Chief Clerk's Office in Room 201S of Building E, 12118 N. Interstate 35, Austin, Texas.

Enclosed are copies of the Proposal for Decision and Order that have been recommended to the Commission for approval. Any party may file exceptions or briefs by filing the original documents with the Chief Clerk of the Texas Commission on Environmental Quality no later than April 1, 2009. Any replies to exceptions or briefs must be filed in the same manner no later than April 11, 2009.

This matter has been designated **TCEQ Docket No. 2008-0164-UCR; SOAH Docket No. 582-08-1719**. All documents to be filed must clearly reference these assigned docket numbers. Copies of all exceptions, briefs and replies must be served promptly on the State Office of Administrative Hearings and all parties. Certification of service to the above parties and an **original and seven copies** shall be furnished to the Chief Clerk of the Commission. Failure to provide copies may be grounds for withholding consideration of the pleadings.

Sincerely,

A handwritten signature in cursive script that reads "Sharon Cloninger".

Sharon Cloninger
Administrative Law Judge

SC/lh
Enclosures
cc: Mailing List

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STYLE/CASE: HHJ, INC / DECKER UTILITIES
SOAH DOCKET NUMBER: 582-08-1719
REFERRING AGENCY CASE: 2008-0164-UCR

**STATE OFFICE OF ADMINISTRATIVE
HEARINGS**

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SOAH DOCKET NO. 582-08-1719
TCEQ DOCKET NO. 2008-0164-UCR

2009 MAR 12 PM 2:37

APPLICATION OF HHJ, INC. DBA
DECKER UTILITIES TO CHANGE ITS
WATER AND SEWER TARIFF IN
MONTGOMERY COUNTY, TEXAS

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BEFORE THE STATE OFFICE OF THE CHIEF CLERKS OFFICE

OF

ADMINISTRATIVE HEARINGS

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WATER AND SEWER TARIFF IN
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BEFORE THE STATE OFFICE CHIEF CLERKS OFFICE

OF

ADMINISTRATIVE HEARINGS

PROPOSAL FOR DECISION

HHJ, Inc. d/b/a Decker Utilities (Decker) seeks approval from the Texas Commission on Environmental Quality (Commission or the TCEQ) to change water and sewer rates for the Decker Oaks and Village at Decker Oaks subdivisions in Montgomery County, Texas, and to recover associated rate-case expenses from its customers. Decker seeks a total revenue requirement of \$827,243,¹ including \$269,120 for its water service and \$558,123 for its sewer service.² Further, Decker seeks to recover rate-case expenses in the amount of \$30,197.23,³ amortized over two years as a surcharge added to customers' monthly bills.

The protesting ratepayers (Protestants) oppose the proposed rate increase, while the Executive Director (ED) of the Commission supports a rate increase for sewer only, and recommends adjustments that would reduce the proposed rates to an annual revenue requirement of \$698,485, including \$181,444 for water and \$523,041 for sewer. The Office of Public Interest Counsel (OPIC) adopts the ED's recommendation.⁴

After considering the issues and evidence presented, the Administrative Law Judge (ALJ) recommends that the Commission grant Decker's request to increase rates, but with the modifications set out below. Further, the ALJ recommends that the Commission authorize Decker to

¹ An annual rate increase of \$351,760 for water and sewer combined is requested. ED Exh. A.

² Pre-filed Testimony of Debi Loockerman, CPA, Decker Exh. 1, at 22.

³ Decker's Replies to Closing Arguments, at 10-11.

⁴ OPIC Closing Argument, at 2.

recover rate case expenses in the amount of \$29,397.23⁵ over two years as a surcharge to customers' monthly bills. Because the ALJ does not agree with any party completely, she is not able to calculate the full impact of her recommended changes. The ALJ asks the ED to provide in his exceptions calculations of revenue requirement and rates that will incorporate the ALJ's recommended changes.

I. PROCEDURAL HISTORY AND DESCRIPTION OF EVIDENCE PRESENTED

A. Procedural History

On November 15, 2007, Decker filed an application (the Application)⁶ with the TCEQ to change its water and sewer utility rates as allowed under the Commission rule found at 30 TEX. ADMIN. CODE (TAC) § 291.22. The Commission received 280 protests, representing more than 10 percent of the 542 water and sewer customers served during the test year, and exceeding the percentage required for review of rate actions, as set out in TEX. WATER CODE ANN. § 13.187 and 30 TAC § 291.27. Accordingly, on January 31, 2008, the Commission referred this matter to the State Office of Administrative Hearings (SOAH) for a contested case hearing to determine whether the proposed rates are just and reasonable, in compliance with the law, and to establish the rates. The Commission issued notice of the preliminary hearing on February 12, 2008, and Decker's customer account manager sent the notice to all of Decker's customers on March 29, 2008.

On April 15, 2008, ALJ Sharon Cloninger conducted a preliminary hearing in this case, at which time jurisdiction and proper notice were established, and the following were designated as parties to this proceeding: Decker, Protestants, the ED, and the OPIC.

The hearing on the merits convened on October 14, 2008, in Houston, Texas. Applicant appeared through its attorney, Mark H. Zeppa; Protestants appeared through their representatives,

⁵ Decker requested \$30,197.23 in rate case expenses including a prospective expense of \$800 for Mr. Zeppa to prepare a motion for rehearing. The ALJ is persuaded by the ED's Replies to Closing Arguments, at 11, that the \$800 to prepare a motion for rehearing should be disallowed.

⁶ Attachment to Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 24-88.

Stacy Y. McCoy-Moquin and Larry Osborne; the ED appeared through Erin Selvera and Trey Jackson, staff attorneys; and the OPIC appeared through Christina Mann, staff attorney. At the end of the day, the parties asked for a recess to discuss settling the case. The parties were unable to reach a settlement, and the hearing on the merits reconvened November 6, 2008, in Austin, Texas, with all parties participating in the proceeding. The record closed January 12, 2009, after the parties submitted written closing arguments and replies. The hearing was not transcribed.

B. Description of Evidence Presented

Decker introduced the testimony of five witnesses: Debi Loockerman, CPA, who sponsored the financial portions of the Application; Bret Fenner, PE, who sponsored the plant and depreciation schedules and the rate design portion of the Application; Robert Weedn, Decker's president and plant operator; Jeffrey Powell, Decker's office manager; and Mr. Zeppa, to establish his fees in relation to rate-case costs.

Protestants introduced the testimony of one witness, Ms. McCoy-Moquin, but presented no technical or expert testimony to rebut or comment on the case presented by Decker.

Instead, the disputed issues were raised by the ED's staff (Staff), who conducted an audit, served discovery, and prepared direct testimony related to the financial and technical aspects of the Application. The ED called two witnesses: Sheresia Perryman,⁷ a TCEQ accountant/auditor, who addressed cost of service or revenue requirement, and Kha Mach, P.E.,⁸ who worked at the time in

⁷ Decker asserts for the first time in its Replies to Closing Arguments that Ms. Perryman is not an expert. *See* Decker's Replies to Closing Arguments, at 4. Decker did not object to the reliability of Ms. Perryman's testimony before trial or when it was offered. Decker neither objected to the expert testimony of Ms. Perryman pursuant to TRE 104(c) nor moved to exclude or disqualify Ms. Perryman as an expert during the hearing. Decker's first-time complaint in its Replies to Closing Arguments that Ms. Perryman is not an expert is untimely and, to the extent it is an objection, is overruled. *See* ED's Reply to Closing Arguments, at 5-6, for a full discussion of the timeliness issue. In addition, the ED complains of Decker's filing of Replies to Closing Arguments without first filing a closing argument; the ALJ accepts Decker's Replies to Closing Arguments. *See* ED's argument at ED's Reply to Closing Arguments, at 1-2.

⁸ Mr. Mach left employment with the TCEQ between the October 14, 2008 proceeding and the November 6, 2008 reconvened hearing.

the Utilities & Districts Section of the Water Supply Division of the TCEQ, and presented the ED's recommendations concerning quality of service, depreciation, water loss and consumption, and proposed water and sewer rate designs. Amended pre-filed testimony of Ms. Perryman and Mr. Mach was offered and admitted at the November 6, 2008 reconvened hearing, after Ms. Perryman revised her numbers in response to Ms. Loockerman's testimony.

II. BACKGROUND

A. Decker's History

Decker operates as a single utility with an integrated water and sewer system in Montgomery County, Texas, under authority of Water Certificate of Convenience and Necessity (CCN) No. 12841 and Sewer CCN No. 20833. Its two service areas—residential subdivisions called Decker Oaks and The Village at Decker Oaks—are close together, receive water and sewer service from the same plant, and are within 20 miles of Decker's business office in Tomball, Harris County, Texas.⁹

Decker's original rates were established at the utility's inception on April 13, 1999. Until the Application was filed, Decker had never requested a rate increase. Decker has been operating at a loss, subsidized until recently by the development company owned by Mr. Weedn, who is Decker's president, sole stockholder/director, and chief utility plant operator.¹⁰

New rates, as proposed in the Application, have been imposed since February 1, 2008, pending the outcome of this proceeding.¹¹ Under Decker's requested rates, the total cost to customers for 10,000 gallons of water would increase from \$27.75 per month to \$48.78 per month, and for 30,000 gallons of water, from \$50.75 per month to \$94.58 per month. The existing sewer

⁹ Pre-filed Testimony of Robert Weedn, Decker Exh. 3, at 7.

¹⁰ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 1 and 12; Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 17.

¹¹ ED Exh. A; Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 17.

rate for 10,000 gallons would increase from \$70 per month to \$184.67 per month.¹² To mitigate rate shock in the future, Decker plans to review rates and file for a smaller increase more often, every two years if appropriate.¹³

The utility's water production facilities consist of two groundwater wells, two groundwater storage tanks, seven booster pumps, and two pressure storage tanks. The distribution system consists of PVC piping with mains varying in size from eight inches to two inches in diameter. The entire water plant is surrounded by a wooden intruder-resistant fence.¹⁴

The utility's sewer treatment facilities consist of the original 87,000 gallons per day (gpd) treatment plant with an additional 400,000 gpd of wastewater treatment plant (WWTP) capacity added in 2005. The collection system's PVC piping varies in size from ten inches to six inches in diameter. The system also has two lift stations. After the Application was filed, the treatment plant was enclosed with an intruder-resistant fence, and the blower building was outfitted with soundproofing insulation and surrounded by a wooden fence.¹⁵

Decker is certified by the Commission as a regional service provider. When obtaining a permit for the WWTP, Decker included a future growth component in the third phase for the WWTP to serve an expanded service area. Currently, there is little alternate sewer service capacity near the Decker service area. The Commission found there was a need for all of Decker's sewer capacity when the TCEQ approved the utility's most recent TPDES wastewater permit.¹⁶

¹² ED Exh. A; Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 53.

¹³ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 17. Mr. Weedn testified that since the February 1, 2008 change in rates, customers' water usage has decreased and Decker's revenue has not been as much as projected. Recording of November 6, 2008 reconvened hearing, beginning at approximately 2:34:17 hours.

¹⁴ Pre-filed Testimony of Mr. Fenner, Decker Exh. 2, at 4.

¹⁵ Neither of these capital improvements was added to Decker's recommended original cost for sewer plant and equipment in the Application. Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 5.

¹⁶ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 5.

B. Decker's Bankruptcy

According to Mr. Weedn, Decker filed for bankruptcy in October 2007 because the utility could not repay the \$1.581 million debt incurred for the 2005 WWTP construction.¹⁷ He explained that a rate increase to insure the utility pays its own way became a key component of the bankruptcy reorganization,¹⁸ so the Application was filed a month later, in November 2007.

Mr. Weedn said at Decker's inception, the utility was so small that its day-to-day operations had to be subsidized by its affiliated development companies at the rate of about \$20,000 per month, with the subsidy continuing as long as development was ongoing, through about 2006; but he noted that the affiliated development companies did not contribute to original plant cost.¹⁹ As the number of customers increased, it became necessary to add WWTP capacity to meet service demands of both the existing customer base and the customer base projected to need service once Decker's CCN areas are built out.²⁰ During the several years it took to permit, finance, and construct the new WWTP, the development companies continued to subsidize Decker's operations.²¹

Traditionally, Decker relied on its development affiliates to generate enough cash flow to fund necessary utility capital plant additions. Decker did not have the cash reserves to fund construction of the new, expanded WWTP, so borrowed money for the project.²² Mr. Weedn expected the real estate operations to generate enough cash to supplement Decker's utility earnings to service the bank debt. As the local real estate market crashed, Decker found itself unable to meet

¹⁷ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 49 (Application, at 24); Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 4.

¹⁸ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 12.

¹⁹ Recording of October 14, 2008 proceeding, beginning at approximately 36:08 minutes in segment HOM 2 of 4.

²⁰ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 4 and 12.

²¹ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 12.

²² Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 5. Mr. Weedn states the loan was from Capital One; the Application shows the loan to be from Hybernia National Bank. *See* Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 49 (Application, at 24). The ALJ finds the witnesses are referring to the same loan.

all its financial obligations for debt service and utility operations. Rather than allow utility services to decline, Mr. Weedn decided to seek reorganization of Decker's debt in bankruptcy in October 2007. A Plan of Reorganization was filed a year later, in October 2008, and was approved. As of the October 14, 2008 hearing date, Decker was in the post-petition phase of the bankruptcy process, according to Mr. Weedn.²³

The utility is now in Mr. Weedn's control as "debtor in possession." Decker is being operated in the same fashion as before, but under a very tight budget set by the bankruptcy court. Day-to-day operating expenses are covered by the budget, but major expenditures must be approved by the bankruptcy court.²⁴ Non-routine and ordinary Decker expenses must be paid for from utility operations' cash flow.

No bankruptcy-related costs were included in Decker's original rates. Therefore, Mr. Weedn said he knows the customers have not paid any bankruptcy costs in the rates charged for the water and sewer utility service they are consuming. He said customers are not being billed for any ongoing bankruptcy expenses.²⁵ Ms. Loockerman testified that any bankruptcy-related expenses used in the Application are representative of the normal level of legal and accounting expenses expected for a regulated utility.²⁶

III. GENERAL LEDGER EXPENSES SHOULD BE ALLOWED

A. Decker's Methodology

During the test year, Decker did not maintain separate water and sewer records. Decker is a very small utility system in comparison with most public water systems in Texas, and both water and

²³ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 5 and 12; recording of October 14, 2008 proceeding, beginning at approximately 33:51 minutes and again at 41:31 minutes in the HOM 2 of 4 segment.

²⁴ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 5-6.

²⁵ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 5.

²⁶ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 6.

wastewater service are provided to all customers.²⁷ In Ms. Loockerman's opinion, it was reasonable for Decker to maintain books in the aggregate for these reasons. When separate records are not kept, reasonably allocating costs between water and sewer is an acceptable means of determining separate rates, she said.²⁸

Ms. Loockerman said she determined Decker's revenue requirement based on the January – December 2006 test year by reviewing Decker's financial statements, including the general ledger; removing from her calculations any non-recurring expenditures and non-utility expenses that were not recoverable from customers; and making adjustments for known and measurable changes. She also reviewed financial information for the months available after the 2006 test period, up to the November 2007 filing of the Application. She interviewed Decker's employees and reviewed selected invoices reflecting test-year expenses.²⁹

B. The ED's Methodology

Although Ms. Loockerman's testimony includes an explanation of her calculations regarding expenses,³⁰ Staff argues the receipts and supporting documentation provided to Staff were insufficient to justify the amounts claimed. Due to the lack of receipts or other supporting documentation, the ED's recommended cost of service includes reductions to the following categories of costs based on lack of receipts, invoices, or other supporting documentation: repairs, maintenance, and supplies; office expenses; accounting and legal fees; notes payable expenses; federal income taxes; and return on net invested capital.³¹ In support of the reductions, Staff relies on the Texas Water Code and the TCEQ rules, which provide that in the course of evaluating a

²⁷ During the test year, there were 542 water customers and 542 sewer customers. Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 4. Mr. Weedn testified at the November 6, 2008 reconvened hearing that up to 20 customers either have water service only, or a second water tap for irrigation purposes only. Recording of November 6, 2008 proceeding, beginning at approximately 2:31:07 hours.

²⁸ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 4.

²⁹ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 3.

³⁰ ED's Closing Argument, at 2-3, referring to Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 5-14.

rate/tariff change request, the ED may request additional information from any utility and if the utility fails to provide within a reasonable time the necessary documentation or other evidence that supports the costs and expenses that are shown on the application, the Commission may disallow the unsupported costs or expenses.³²

C. The OPIC's Position

OPIC argues that Decker attempted to dismiss the ED's concerns that invoices or receipts do not exist for many of the claimed costs by demanding that Ms. Perryman point to a specific statute or rule that requires privately-owned water utilities to keep such records.³³ OPIC points out that Decker's strategy ignores its burden to demonstrate that the rate is just and reasonable as required by 30 TAC § 291.12. OPIC agrees with the ED that an applicant must have some record of expenses other than a general ledger entry when requiring water and wastewater consumers to pay additional funds to an entity that has a monopoly on providing those services. OPIC acknowledges that water and wastewater service providers have every right to charge a tariff that accurately reflects a cost of service and earns a rate of return, but argues it is the responsibility of those providers to present documentation supporting the claimed expenses. OPIC agrees with the ED that expenses that cannot be verified should not be borne by the consumer.³⁴

D. ALJ's Analysis and Conclusion

Having considered the arguments of the ED and the OPIC regarding disallowing certain expenses because Decker did not provide requested supporting documentation, the facts of this case, and applicable law, the ALJ recommends that the Commission should take the ED's expenses

³¹ ED's Closing Argument, at 2-3, referring to Ms. Perryman's amended testimony, ED Exh. 1-A.

³² ED's Closing Argument, at 2, referring to TEX. WATER CODE ANN. § 13.187(c) and 30 TAC § 291.28(4).

³³ Recording of November 6, 2008 reconvened hearing, beginning at approximately 18:30 minutes.

³⁴ OPIC Closing Argument, at 5.

disallowed for lack of supporting documentation into consideration in determining Decker's water and sewer rates, for the reasons set out below.

The following law applies:

The utility's rate/tariff application must include information the regulatory authority requires by rule. If the utility fails to provide within a reasonable time after the application is filed the necessary documentation or other evidence that supports the costs and expenses that are shown in the application, the regulatory authority may disallow the non-supported costs or expenses. TEX. WATER CODE ANN. § 13.187(c).

The ED or Commission may request additional information from any utility in the course of evaluating the rate/tariff change request, and the utility shall provide that information within 20 days of receipt of the request, unless a different time is agreed to. If the utility fails to provide within a reasonable time after the application is filed the necessary documentation or other evidence that supports the costs and expenses that are shown in the application, the Commission may disallow the unsupported costs or expenses. 30 TAC § 291.28(4).

There is no information in evidence as to what constitutes "necessary documentation" under TEX. WATER CODE ANN. § 13.187(c). Decker provided its general ledger as well as invoices, check stubs, and/or receipts that supported some, but not all, of the expenses contained in the Application.

Decker's counsel elicited testimony from Ms. Perryman that she knows of no law or rule that requires a utility to keep invoices or check stubs to support information contained in its general ledger. While Ms. Perryman could point to no rule, she did say that auditors rely on invoices, receipts, and/or check stubs to verify figures contained in general ledgers.³⁵

Nor is there evidence as to what "additional information"—as set out in 30 TAC § 291.28(4)—was requested by the ED during the discovery period or as part of its April 2008 audit of Decker. Assuming the ED requested invoices, check stubs, and/or receipts to verify certain

information contained in the Application, and that Decker did not produce them, the Commission may disallow—but is not required to disallow—the expenses supported only by the general ledger.

The rules of statutory construction, found at TEX. GOV'T CODE ANN. § 311.016, state that the word “may” creates a discretionary authority or grants a permission or power.

In relevant part, TEX. WATER CODE ANN. § 13.183(a) states:

In fixing the rates for water and sewer services, the regulatory authority shall fix its overall revenues at a level that will (1) permit the utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses; and (2) preserve the financial integrity of the utility.

Ideally, Decker would have produced all the underlying documentation, but did not. Even so, the evidence shows expenses as calculated by Ms. Loockerman and included in the Application to be reasonable and necessary. Decker's expert witness Ms. Loockerman removed general ledger items from allowable expenses if she found them to be misclassified, a non-utility expense, a regulatory expense, or for personal use.³⁶ Overall Mr. Weedn believes the test year cost of service for water and sewer adjusted by Ms. Loockerman for known and measurable changes reflects Decker's current cost of providing water and sewer utility service. He said he knows this in part because he pays the utility's bills.³⁷

Decker filed for bankruptcy in 2007 precisely because its affiliated development companies could no longer afford to subsidize the utility at about \$20,000 per month, as they had from the utility's inception until about 2006, and the utility's cash flow was not enough for Decker to service the debt for its 2005 WWTP expansion, necessary to serve its existing and projected customer base.

³⁵ Recording of November 6, 2008 reconvened hearing, beginning at approximately 39:30 minutes.

³⁶ See Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 85-88 (Application, at Attachment D).

³⁷ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 11-12.

Due to the subsidy, Decker's customers paid artificially low water and sewer rates until the proposed rates were imposed in February 2008. Now, for Decker to continue as a viable company, customers will have to pay rates that absorb the former subsidy and result in enough cash flow for the WWTP debt to be serviced.

Disallowing general ledger items for Decker's failure to produce supporting documentation would result in a revenue requirement below Decker's actual cost of service, and in water and sewer rates that would not generate enough revenue for Decker to remain in business. Therefore, the ALJ recommends that the expenses unsupported by invoices, receipts, and/or check stubs not be disallowed, because disallowing the expenses in determining Decker's water and sewer rates would not preserve the financial integrity of the utility.

IV. COST OF SERVICE

Rates are based on a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on invested capital. 30 TAC § 291.31(a).

A. Allowable Expenses

Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses. In computing a utility's allowable expenses, only the utility's historical test year expenses as adjusted for known and measurable changes may be considered. 30 TAC § 291.31(b). The components of allowable expenses, to the extent they are reasonable and necessary, may include, but are not limited to, operations and maintenance expense; depreciation expense; assessments and taxes other than income taxes; federal income taxes; reasonable expenditures for ordinary advertising, contributions, and donations; and funds expended in support of membership in professional or trade associations. 30 TAC § 291.31(b)(1).

1. Operations and maintenance expense

Operations and maintenance expense incurred in furnishing normal utility service and in maintaining utility plant used by and useful to the utility in providing such service is allowed, but payments to affiliated interests for costs of service, or any property, right, or thing, or for interest expense are not allowed as an expense for cost of service except as provided in TEX. WATER CODE ANN. § 13.185(e).³⁸ 30 TAC § 291.31(b)(1)(A)

Ms. Loockerman described her methodology for allocations in Texas as reasonable and accepted by the industry. She said all her allocations for operations and maintenance—with the exceptions of repairs and maintenance, federal income tax, and the Texas business tax—are based on the number of connections for water and sewer, which were equal at the end of the test year (542 connections each). Where information was available, she allocated repairs and maintenance expenses directly to the water or sewer cost of service. All other repairs and maintenance expenses were allocated by number of connections.³⁹ For federal income taxes and the Texas business tax, she pro-rated the allocation based on the different revenue requirements for water and sewer excluding taxes.⁴⁰

³⁸ Payment to affiliated interests for costs of any services, or any property, right or thing, or for interest expense may not be allowed either as capital cost or as expense except to the extent that the regulatory authority finds that payment to be reasonable and necessary. A finding of reasonableness and necessity must include specific statements setting forth the cost to the affiliate of each item or class of items in question and a finding that the price to the utility is no higher than prices charged by the supplying affiliate to its other affiliates or divisions for the same item or items, or to unaffiliated persons or corporations. TEX. WATER CODE ANN. § 13.185(e). See the “payments to affiliated interests” section of this Proposal for Decision, *infra*, at IV.A.1.k.

³⁹ Ms. Loockerman’s pre-filed testimony, Decker Exh. 1, at 4-5.

⁴⁰ Ms. Loockerman’s pre-filed testimony, Decker Exh. 1, at 87-88 (Application, at Attachment D, at 2-3).

a. salaries and wages

i. Decker's evidence and argument

Ms. Loockerman found test year salaries and wages to total \$104,748 for four permanent positions: two full-time office staff, a plant superintendent or foreman;⁴¹ and Mr. Weedn, the owner, manager, and certified operator of Decker.⁴² Ms. Loockerman explained that Mr. Weedn's compensation does not appear in the expenses portion of Decker's general ledger, but as "draws," which are a form of compensation.⁴³ After accounting for those draws, Ms. Loockerman shows salary expenses of \$146,000 in the adjusted test year, an amount she characterizes as reasonable for a utility the size of Decker.⁴⁴

She said as a utility with 542 connections each for water and sewer, Decker needs two office personnel, at least, to manage billing, customer service questions, telephones, bookkeeping, and to back each other up; and two certified operators, as required by TCEQ rules for this size utility. She said a plant superintendent or foreman is needed for immediate repairs and maintenance; maintaining the aesthetic quality of the plant; repairs of the plants, lines, and pumps; meter reading and replacement; customer lockouts and reconnects; and giving visitors and government employees on official business access to the plant.⁴⁵

⁴¹ Decker's plant superintendent Paul Ramirez is not a certified operator. Under TCEQ rules, a utility of Decker's size needs two certified operators. Decker has contracted with Aucoin & Associates to provide a second certified operator. Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 7 and 11-12. *See also* the "contract labor" section of this Proposal for Decision, *infra*, at IV.A.1.b.

⁴² Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 6.

⁴³ The bankruptcy court classifies these draws as compensation for services rendered, not as note payments. Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 7 and 9.

⁴⁴ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 6, and 86 (Application, Attachment D).

⁴⁵ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 7.

Ms. Loockerman said the \$42,000 she included in the salary expenses of \$146,000 for Mr. Weedn's compensation is reasonable, and his services are necessary.⁴⁶ Since Decker's inception in the late 1990s, Mr. Weedn has managed operations and administration, provided certified operator services required by TCEQ rules, made executive decisions for the utility, supervised staff and day-to-day operations, been the engineer of the plant, and represented the utility in public and in legal matters. Mr. Weedn works 65-80 hours per week on utility management and operations. In Ms. Loockerman's view, Mr. Weedn's services continue to be necessary and reasonable to Decker's operations and to providing good water and sewer service to its customers.⁴⁷

Ms. Loockerman arrived at \$42,000 in compensation for Mr. Weedn after considering the following factors: he worked 65-80 hours per week for the utility in the historical test year and the following year; he continues to be on call around the clock; he could commute the approximately 30 miles from Tomball to Houston and make substantially more than the \$42,000 included in the cost of service doing basically the same job, and probably with less overtime; the Division Manager for the City of Houston's solid waste management department makes between \$49,010 and \$75,452 annually (2008 position); and Houston and Tomball obtain employees from the same labor pool.⁴⁸

Ms. Loockerman concludes that if Mr. Weedn were not compensated for the duties he performs, Decker would probably have to hire a business manager plus a licensed water/sewer operator, at a cost for those two salaries that would exceed the \$42,000 in salary requested for Mr. Weedn in the Application.⁴⁹

Ms. Loockerman allowed \$104,000 to pay Decker's two office personnel and the plant superintendent. The 2007 salary total for these three employees was only \$65,999, but contract labor

⁴⁶ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 10. The bankruptcy court allowed \$84,000 in compensation for Mr. Weedn. Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 9.

⁴⁷ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 7-9.

⁴⁸ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 10.

⁴⁹ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 8.

in the amount of \$27,570 was used (mostly for clerical and office help) when salaried personnel were gone, bringing the 2007 total to \$93,569.⁵⁰ Although this is \$10,431 less than the \$104,000 projected for these three positions, Ms. Loockerman believes the \$104,000 allocation still should be used. She explained that because office personnel are paid by the hour rather than on salary, one could expect reasonable variation from the projected changes.⁵¹

ii. The ED's evidence and argument

The ED presented no evidence or argument related to salaries and wages.

b. contract labor

i. Decker's evidence and argument

Ms. Loockerman allowed \$26,400 in her revenue requirement for contract labor, including \$4,800 in miscellaneous contract labor for the test year and a known and measurable increase of \$21,600 for a second certified plant operator.⁵² Ms. Loockerman explained that Decker retained the services of the second certified plant operator in February 2008 to meet TCEQ requirements for a utility of Decker's size.⁵³ The base contract price is \$1,500 per month, or \$18,000 per year. Additional hours are billed at \$45 per hour. Her known and measurable changes include the base \$18,000 plus \$3,600 for 60 additional hours of service, for a total of \$21,600.

In Ms. Loockerman's opinion, including this known and measurable change in allowable expenses is reasonable even though it did not occur until 2008, because the new rates for this

⁵⁰ Actual contract labor of \$27,570 (mostly for office and clerical help) in 2007 does not include the second certified plant operator as shown in Ms. Loockerman's known and measurable changes; the contract for the new operator did not go into effect until February 1, 2008. Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 10-11.

⁵¹ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 10-11.

⁵² Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 11.

⁵³ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 11-12.

Application were not effective until February 1, 2008, which means the proposed rates are actually being set for 2008, not for 2007. She said no future rate case will recover the 2008 operator contract expenditures because any future rate cases will be effective after February 1, 2009. She said the second operator revenue requirement would be inappropriately lost by Decker if this known and measurable change is not allowed in this rate case. She also pointed out that to disallow this known and measurable change would penalize Decker for adding a second operator as required by the TCEQ.⁵⁴

ii. The ED's evidence and argument

The ED did not challenge Decker's contract labor expenses.

c. utility expenses⁵⁵

The test year utility cost of \$46,280 is reasonable and necessary to provide water and wastewater service to the public, according to Ms. Loockerman. Although utility costs increased to \$60,697 in 2007, she did not include the \$14,417 increase in known and measurable changes.⁵⁶ She said if any other types of expenses are decreased to reflect 2007 costs, then this increase and any others must be counted to obtain a fair cost of service.⁵⁷

⁵⁴ Ms. Loockerman did not know of any statutes or rules followed by Texas utility rate analysts that limit post-test year known and measurable changes to the 12 months following the test year. She is only aware of an instruction in sections VI(2)—water and VI(2)—sewer of the rate filing package directing an applicant to explain any known and measurable changes listed that occurred in the 12 months following the test year. As a professional rate consultant and former TCEQ rate staff member, she does not believe that an instruction in the rate filing package carries the weight of statute or rule. Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 12-13, 40, and 52 (Application at 15 and 27).

⁵⁵ The evidence did not establish whether utility costs include anything other than expenses for electricity.

⁵⁶ Ms. Loockerman testified she could not justify her charge to re-calculate the cost of service for this known and measurable change, so did not do so. She noted that Decker will recover enough revenue to do without the added \$14,417 if its recommended cost of service and a reasonable rate of return are approved by the Commission. Recording of October 14, 2008 proceeding, beginning at approximately 1:05:28 hours in segment HOM 1 of 4.

⁵⁷ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 13.

d. repairs and maintenance

i. Decker's evidence and argument

The \$45,996 in repairs and maintenance included in the cost of service is reasonable and necessary to provide service to Decker's customers, according to Ms. Loockerman. She said non-utility items, misclassified items, and discontinued items were removed from Attachment D in the Application.⁵⁸ Where information was available, she allocated repairs and maintenance expenses directly to the water or sewer cost of service. All other repairs and maintenance expenses were allocated by number of connections.⁵⁹ She noted that repairs and maintenance expenses will vary from year to year, pointing out that in 2005, Decker's federal income tax return showed \$78,368 in repairs, maintenance, and plant maintenance, while the 2007 repairs and maintenance expense was only \$33,583. But she speculated that in 2007, some repair and maintenance costs were probably delayed due to the bankruptcy court action and budgetary limitations.⁶⁰

ii. ED's evidence and argument

Ms. Perryman recommends reducing repairs, maintenance, and supplies expense shown to be \$45,996 in the Application by \$7,118 for water and \$7,121 for wastewater. Part of the reduction is recommended because one of the invoices reviewed by Ms. Perryman was outside the test period,⁶¹ and the remaining recommended disallowance is because Decker did not provide invoices or other documentation to support the expenses during Staff's April 2008 audit or during the discovery

⁵⁸ The known and measurable changes for repairs and maintenance expenses are allocated equally between water and sewer, except for one \$1,500 payment that is removed only from sewer, bringing the total expense for water to \$15,141 and for sewer to \$30,855. *See* Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 86 (Application, Attachment D, at 1).

⁵⁹ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 4-5.

⁶⁰ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 14.

⁶¹ The specific invoice is not identified; the ALJ cannot determine from the evidence admitted if Ms. Loockerman disallowed the same invoice.

period.⁶² Staff was not able to arrive at Ms. Loockerman's allocation⁶³ because there was no supporting documentation to identify which invoices were specifically for water and which were for wastewater. Therefore, Staff allocated 50 percent for water and 50 percent for sewer, because each service has 542 connections.⁶⁴

e. office expenses

i. Decker's evidence and argument

Office expenses of \$24,717 are reasonable and necessary for Decker to provide service to its customers, Ms. Loockerman said. As set out in Attachment D of the Application, Ms. Loockerman removed substantial non-utility expenses from this category. She increased rent expense due to a change in Decker's lease contract resulting in additional conference and storage space being used by the utility. She noted that the higher rent payments began after the historical test year,⁶⁵ so included the 2007 rent increase as a \$7,788 known and measurable change.⁶⁶

ii. ED's evidence and argument

Staff recommends reducing office expenses shown to be \$24,717 in the Application by \$4,818.24, or \$2,409.12 each for water and sewer. Ms. Perryman said Decker did not provide invoices or other supporting documents for \$4,818.24 in office expenses, including telephone expenses of \$1,983, when requested by Staff during the April 2008 audit and the discovery period, so Staff could not determine if the expenses were for the utility or for personal use.⁶⁷

⁶² Ms. Perryman's amended testimony, ED Exh. 1-A, at 4-5.

⁶³ Staff incorrectly states that Ms. Loockerman's allocation was 18 percent for water and 82 percent for sewer.

⁶⁴ Ms. Perryman's amended testimony, ED Exh. 1-A, at 4-6. *See* exhibits ED-SP-1 and ED-SP-5 for details related to the reductions; *also*, refer to exhibits ED-SP-11, ED-SP-14, and ED-SP-15.

⁶⁵ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 14.

⁶⁶ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 86 (Application, Attachment D, at 1).

⁶⁷ Ms. Perryman's amended testimony, ED Exh. 1-A, at 6-7; *see* exhibits ED-SP-1 and ED-SP-5 for details; *see*

f. accounting and legal expenses

i. Decker's evidence and argument

Ms. Loockerman believes her recommended \$9,071 in allowable expenses for accounting and legal costs is below what Decker will actually incur in the foreseeable future, but the requested amount is reasonable to impose on customers. She said she did not use the historical test year number for accounting and legal expenses, because of costs associated with the bankruptcy proceedings, as well as with TCEQ enforcement and permitting activities.⁶⁸ She amortized legal expenses over 2006 and 2007, producing a decrease of \$774 in the historical test year expense; in 2007, the actual legal expenses came to \$8,296, after \$9,000 in rate case expenses were excluded.⁶⁹ The \$9,071 recommendation represents normalized legal and accounting expenses over a two-year period.⁷⁰

ii. ED's evidence and argument

Staff recommends removing legal and accounting fees in an equally allocated reduction of \$1,172.50 each for water and sewer, because Decker did not provide invoices or other documentation to support these expenses during the April 2008 audit or the discovery period.⁷¹

also exhibits ED-SP-9, ED-SP-10, ED-SP-12, ED-SP-14, and ED-SP-15.

⁶⁸ Ms. Loockerman's calculations may be found at Decker Exh. 1, at 87 (Application, Attachment D, at 2).

⁶⁹ Ms. Loockerman testified she does not know how much of the \$8,296 is for the bankruptcy proceedings. Recording of October 14, 2008 proceeding beginning at approximately 15:50 minutes in segment HOM 1 of 4.

⁷⁰ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 15.

⁷¹ Ms. Perryman's amended testimony, ED Exh. 1-A, at 7-8; *see* exhibits ED-SP-1 and ED-SP-5; *see also* exhibits ED-SP-14 and ED-SP-15.

g. insurance expenses

i. Decker's evidence and argument

Ms. Loockerman said the requested \$18,741 for insurance cost of service is reasonable and necessary to provide service to Decker's customers. The expense includes \$17,083 for liability and auto insurance, and \$1,658 for life insurance on Mr. Weedn, which is a reasonable benefit to him as Decker's owner. She noted that the total insurance cost in 2007 increased to \$27,131, but said she did not use the figure as a known and measurable change, because the increased amount was out of the range of reasonableness. She removed interest expense from the cost of insurance, because interest expense is excluded from the cost of service in the utility methodology of rate making.⁷²

ii. ED's evidence and argument⁷³

Ms. Perryman proposes the reduction in notes payable expenses of \$7,171 apiece for water and sewer, for a total of \$14,342, because the note payable to Universal Premium Acceptance Corporation for a loan for insurance payments to Darryl Forbes Insurance Agency was also submitted under insurance expenses.⁷⁴ Ms. Perryman testified that she counted the \$14,342 under insurance expenses rather than under notes payable,⁷⁵ whereas Ms. Loockerman included the \$14,432 to Universal Premium Acceptance Corporation as a combined note payable for both water and sewer, at 12.74 percent interest.⁷⁶

⁷² Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 16 and 87 (Application, Attachment D, at 2).

⁷³ *But see* "insurance expenses," *supra*, at IV.A.1.g. in this Proposal for Decision.

⁷⁴ Ms. Perryman's amended testimony, ED Exh. 1-A, at 8; *see* exhibits ED-SP-2 and Exh. ED-SP-6 for additional detail about the reductions; *see also* ED-SP-13, which is a copy of the Premium Finance Agreement and Disclosure Statement.

⁷⁵ Recording of November 6, 2008 reconvened hearing beginning at approximately 16:28 minutes.

⁷⁶ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 37 and 49 (Application, at 12 and 24).

h. miscellaneous known and measurable decreases

Ms. Loockerman adjusted the cost of service for a known and measurable decrease of \$5,776 due to removal of non-utility items and the regulatory assessment fee from the historical test year expenses.⁷⁷

i. reductions in other revenue

Ms. Loockerman said she reduced revenues in 2007 by \$13,290, because no new tap fees were collected, since Mr. Weedn's development company did not construct buildings that year.⁷⁸ She reduced tap fees to zero, but counted \$3,125 in other miscellaneous fees as revenue.⁷⁹

j. payments to affiliated interests

In response to concerns that Decker might be paying utility expenses that should be billed to its affiliated development company, Mr. Powell explained there are five Reliant Energy accounts because there are separate meters and accounts for each of the two sides of the office, the lift station, the sewer plant, and the water plant. He said Decker pays for goods and services used by or benefiting the utility regardless of whose name the supplier puts on the invoice.

⁷⁷ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 17-18, and 87 (Application, Attachment D, at 2). In a note on Attachment D, Ms. Loockerman explains she amortized the actual 2006 accounting and legal expenses of \$9,845 over 2006 and 2007, for \$4,923 per year; she also amortized the actual 2007 accounting and legal expenses of \$8,296 (\$17,296 less \$9,000 in rate case expense) over 2007 (as a known and measurable change) and 2008 to arrive at \$4,148 per year. Her total accounting and legal expense for the adjusted test year is \$9,071 (\$4,923 plus \$4,148) divided evenly between water and sewer for \$4,536 each.

⁷⁸ No development had occurred as of March 1, 2008. Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 22.

⁷⁹ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 22.

Mr. Powell also testified that Decker's affiliated companies used to share space with the utility, but Decker currently is the only occupant of the space at 617 W. Main in Tomball, Texas, and pays the full lease, which was considered Decker's sole expense within the bankruptcy.⁸⁰

Also, checks totaling \$45,704.46 were written from Decker to Decker Oaks Development II, Ltd., in 2006 for expenses that were at the time being "split" between the companies. Mr. Powell explained that the payment to North West Pool and Landscape was for occasional maintenance of the lawn at the water and sewer plants.⁸¹

2. Depreciation expense

Depreciation expense is based on original cost and computed on a straight line basis over the useful life of the asset as approved by the Commission. Depreciation is allowed on all currently used depreciable utility property owned by the utility except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. Depreciation on all currently used and useful developer or governmental entity contributed property is allowed in the cost of service. 30 TAC § 291.31(b)(1)(B)

a. Decker's evidence and argument

Mr. Fenner calculated the depreciation expense, using the TCEQ's recommended useful life for each of the plant items. He said depreciation is recognized as a line item in the cost of service that allows the utility to recover the cost of an asset over the useful life of that asset. The TCEQ requires

⁸⁰ Mr. Powell's pre-filed testimony, Decker Exh. 4, at 8.

⁸¹ Mr. Powell's pre-filed testimony, Decker Exh. 4, at 9. No further evidence was presented regarding the splitting of costs between Decker and the development companies, although Protestants elicited testimony from Mr. Weedn that the Decker Oaks homeowners association pays the electric bill for the pump used at the retention pond located at the same address as Decker's lift station. Mr. Weedn clarified that the retention pond is for storm drainage and is not part of Decker's plant. Recording of October 14, 2008 proceeding, beginning at approximately 11:49 minutes in segment HOM 2 of 4.

straight-line depreciation which is calculated by taking the original cost of an asset, such as a pump, and dividing that cost by the number of years of its recommended useful life.⁸²

i. how Mr. Fenner determined original cost⁸³

Mr. Fenner explained that no historical records are on file with the TCEQ regarding Decker's original cost of the plant, design considerations, and installation dates, because Decker has not previously filed a rate change application. Since that information is not on file, Mr. Fenner used inspections, interviews, and a records search to determine the original installed cost, annual depreciation, total accumulated depreciation, and net book value for both the water and sewer plants and equipment that is used and useful in providing water and sewer service to Decker's customers.⁸⁴ The date of installation was determined either by a search of historical records or information provided by the utility.⁸⁵

Mr. Fenner testified that he determined Decker's original plant value through trending, because no original cost invoices were available.⁸⁶ Mr. Fenner described trending as a method of taking the known cost of an item, such as a storage tank, at a known date and determining the cost of that item at a different point in time based on construction cost changes or trends over the years.⁸⁷ He used the Handy-Whitman Index of Public Utility Construction Costs (the Handy-Whitman Index), the standard used by regulatory entities to perform trending analysis. This publication

⁸² Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 6. *See also* Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 18-19, and at 35 for the Original Cost and Depreciation Schedule—Water (Application, at 10) and at 47 for the Original Cost and Depreciation Schedule—Sewer (Application, at 22).

⁸³ *See* 30 TAC § 291.31(c)(2)(A)(i).

⁸⁴ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 3.

⁸⁵ Mr. Fenner testified that trend analysis is an acceptable alternative for determining original plant value when invoices are not available.

⁸⁶ Recording of October 14, 2008 proceeding, beginning at approximately 1:40:00 hours.

⁸⁷ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 8.

provides ratios of construction costs for utility equipment for every year since the early 1900s, he said.⁸⁸

ii. original cost, depreciation, and net book value

For Decker's water plant, Mr. Fenner recommended an original cost of \$669,258; annual depreciation of \$20,255; accumulated depreciation of \$105,182; and net book value of \$564,076.⁸⁹

For Decker's sewer facilities, Mr. Fenner recommended an original cost of \$2,827,441; annual depreciation of \$57,018; and net book value of \$2,624,293.⁹⁰ If corrected based on his testimony at hearing, Mr. Fenner's accumulated depreciation figure becomes \$305,966,⁹¹ which yields a net book value of \$2,521,374.⁹²

b. ED's evidence and argument

Mr. Mach conducted a field inspection of Decker's facilities on April 8, 2008, and verified that the items claimed in the Application's depreciation schedules are used and useful in providing water and sewer service to Decker's customers. Mr. Mach said he used the depreciation schedules in

⁸⁸ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 7-8. *See* exhibit BWF-3 for Mr. Fenner's trend analysis for water and sewer cost items.

⁸⁹ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 7.

⁹⁰ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 7.

⁹¹ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 7. Note that although the accumulated depreciation is listed as \$203,148 in his pre-filed testimony, he testified at hearing that the \$101 figure used for accumulated depreciation for man holes in BWF-2 should have been about \$101,000. If the \$10,302 in annual depreciation is multiplied by 10 years, as listed in exhibit BWF-2, the total is \$103,020. If \$101 is subtracted from the listed accumulated depreciation of \$203,148, and \$103,020 is then added to the remainder of \$203,047, the total accumulated depreciation is \$305,966. Recording of October 14, 2008 proceeding, beginning at approximately 1:50:01 hours in segment HOM 1 of 4.

⁹² The incorrect \$101 for man holes is added back in to the recommended net plant of \$2,624,293, for a sum of \$2,624,394. The correct accumulated depreciation of \$103,020 is then subtracted from \$2,624,394, for a net plant of \$2,521,374.

the Application, without making any adjustments, because this is Decker's first rate change application.⁹³

i. how Mr. Mach determined original cost

Mr. Mach's adjustments to Decker's water plant are not based on original costs claimed in the Application, because Decker did not provide any receipts to verify original costs or explain how the costs submitted in the Application were developed. Instead, Mr. Mach's adjustments are based on the Handy-Whitman Index, using Bulletin No. 162, published July 1, 2005.⁹⁴

Neither are Mr. Mach's adjustments to Decker's sewer plant based on original costs claimed in the Application. Again, Decker did not provide any receipts to verify original cost or explain how original cost was developed as listed in the Application.⁹⁵ Instead, Mr. Mach calculated the ratio between the Handy-Whitman Index of 2000 and the Handy-Whitman Index, Bulletin 162, published July 1, 2005 (the year of the WWTP expansion). The trended cost is the product of cost quotes, the number of units, the Handy-Whitman Index ratio, and the city cost index.⁹⁶

For both the water plant and sewer plant calculations, values for the original cost, annual depreciation, accumulated depreciation, and net plant value were figured using the straight line depreciation method with Mr. Mach's calculated trended costs and price quotes, and city cost indexes provided in Decker's supplement dated July 29, 2008, and no salvage value, as required by TCEQ rules to calculate the net plant values for the rate base.⁹⁷

⁹³ Mr. Mach's amended testimony, ED Exh. 2-A, at 5-6.

⁹⁴ Mr. Mach's amended testimony, ED Exh. 2-A, at 7; *see* exhibits ED-KM-1 and ED-KM-1a to compare the ED's calculations with those of Decker's expert.

⁹⁵ Mr. Mach's amended testimony, ED Exh. 2-A, at 7-8; *see* exhibits ED-KM-2 and ED-KM-2a to compare the ED's calculations with those of Decker's expert.

⁹⁶ Mr. Mach's amended testimony, ED Exh. 2-A, at 8; *see* exhibits Exh. ED-KM-1 for water and ED-KM-2 for sewer.

ii. original cost, depreciation, and net plant

For water plant, Mr. Mach calculated an original cost of \$516,259; annual depreciation of \$15,983; accumulated depreciation of \$83,350; and a net value of \$427,910.⁹⁸

Mr. Mach's calculated original cost of the sewer plant is \$2,404,722; annual depreciation is \$48,546; accumulated depreciation is \$237,601; and net value is \$2,167,120.⁹⁹

iii. Staff's argument against Decker's calculations

Staff argues that Mr. Mach testified as to which versions of the Handy-Whitman Index he used to conduct his trending analysis, while Mr. Fenner did not specify which version of the Handy-Whitman index he used to establish the rates and calculate the trended costs.¹⁰⁰

In addition, Staff points out that Mr. Fenner's testimony regarding accumulated depreciation for sewer utility plant contains errors affecting the net book value for the system. Specifically, during cross examination, Mr. Fenner acknowledged that the total accumulated depreciation for the sewer utility plant as evidenced in BWF-2 is incorrect because the 10-year remaining life for the manholes should be in the neighborhood of \$101,000 instead of \$101 as listed.¹⁰¹ Staff concludes that because of this miscalculation, Mr. Fenner's net book value is incorrect.¹⁰²

⁹⁷ Mr. Mach's amended testimony, ED Exh. 2-A, at 7-8.

⁹⁸ Mr. Mach's amended testimony, ED Exh. 2-A, at 7; *see* exhibits ED-KM-1 and ED-KM-1a to compare the ED's calculations with those of Decker's expert.

⁹⁹ Mr. Mach's amended testimony, ED Exh. 2-A, at 7-8; *see* exhibits ED-KM-2 and ED-KM-2a to compare the ED's calculations with those of Decker's expert.

¹⁰⁰ ED's Closing Argument, at 3, citing Mr. Fenner's pre-filed testimony, Decker Exh. 1, at 7-8. The ALJ takes the ED's point to be that Mr. Mach's trending analysis is more reliable than Mr. Fenner's is, but notes that Mr. Mach testified that Mr. Fenner used the year 2000 Handy-Whitman Index. Recording of October 14, 2008, beginning at approximately 31:12 minutes in segment HOM 4 of 4.

¹⁰¹ Recording of October 14, 2008 proceeding, beginning at approximately 1:50:01 hours in segment HOM 1 of 4.

¹⁰² *See* footnote 92 in this Proposal for Decision for figures adjusted based on the ED's Closing Argument, at 3-4. *See* Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 7, table 2.

3. assessments and taxes other than income taxes¹⁰³

a. Decker's evidence and argument

i. Payroll taxes

Due to Decker's higher expenditure for salaries in 2007, Ms. Loockerman calculated a known and measurable increase to payroll taxes of \$14,600. She said no payroll tax payments at all were recorded in the appropriate expense category of Decker's 2006 general ledger.¹⁰⁴

ii. Property taxes and Texas business tax

Ms. Loockerman found a total known and measurable decrease of \$2,764 for Decker's property taxes and the Texas business tax (formerly the Texas franchise tax). Property taxes were reduced from \$6,964 (more than one year's worth) to the 2006 invoiced amount of \$1,124, for a decrease of \$5,840. Decker's Texas business tax liability was calculated based on the new revenue requirement and House Bill 3 signed by Governor Rick Perry replacing the franchise tax in Texas, for a known and measurable increase of \$3,076. The net change was \$3,076 (business tax) minus \$5,840 (property tax), for a decrease of \$2,764.¹⁰⁵

b. ED's evidence and argument

The ED presented no testimony regarding payroll taxes or business tax.

¹⁰³ See 30 TAC § 291.31(b)(1)(C).

¹⁰⁴ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 18 and 87 (Application, Attachment D, at 2).

¹⁰⁵ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 18 and 87 (Application, Attachment D, at 2). Attachment D shows property tax to be allocated equally between water and sewer, and Texas business tax is allocated on basis revenue requirement excluding taxes: Water-- $\$228,631/707,181 \times \$3,076 = \$994$; Sewer-- $\$478,550/707,181 \times \$3,076 = \$2,082$.

4. federal income taxes on a normalized basis¹⁰⁶

a. Decker's evidence and argument

Ms. Loockerman's calculation of \$107,511 for federal income tax is based on the gross cost of service for water and sewer combined, because Decker is an integrated utility and is subject to tax rates on the gross cost of service rather than separately for water and sewer.¹⁰⁷ To arrive at the \$107,511 figure, Ms. Loockerman calculated a normalized federal income tax based on the adjusted test-year revenue requirement less expenses.¹⁰⁸ She said her approach makes more sense than Staff's per-connection allocation for federal income tax, which divides the liability equally between water and sewer.¹⁰⁹

b. ED's evidence and argument

Ms. Perryman proposes a \$34,758 reduction in federal income tax liability for water, and an increase of \$10,544 in federal income tax for sewer, for a total revenue requirement of \$83,297 for federal income tax (including the surtax exemption), as opposed to the \$107,511 listed in the Application.¹¹⁰

¹⁰⁶ See 30 TAC § 291.31(b)(1)(D).

¹⁰⁷ Ms. Loockerman took the combined water and sewer revenue requirement of \$833,492, subtracted the income tax expense of \$107,511 as well as the \$18,800 expense for other taxes, and arrived at a revenue requirement of \$707,181 excluding taxes. The \$107,511 was then allocated on basis revenue requirement excluding taxes: Water - $\$228,631/707,181 \times \$107,511 = \$34,758$; Sewer - $\$478,550/707,181 \times \$107,511 = \$72,753$. See Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 18, and 87-88 (Application, Attachment D, at 2-3).

¹⁰⁸ Ms. Loockerman used the federal tax rates for corporations for 2007 from CCH's 2007 Master Tax Guide, at 136-137. Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 19-20. Normalization is required by 30 TAC § 291.31(b)(1)(D). Ms. Loockerman explained that under the normalization approach, tax laws allow accelerated expenditures that defer current year tax liability more evenly over the years, and match the estimated normalized liability with the period in which the tax expense would be incurred, if tax laws did not cause variations. This practice closely parallels generally accepted accounting principles for matching revenues with expenses in a year. If the normalization approach is not used, revenue from Decker's current customers would be used to pay little or no taxes, and future Decker customers would pay more taxes. In addition, the actual tax liability could vary from year-to-year due to tax law changes. Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 19-20.

¹⁰⁹ Decker Exh. 1, at 4-5, 19-20, and 88 (Application, Attachment D, at 3).

¹¹⁰ Ms. Perryman's amended testimony, ED Exh. 1-A, at 8-9; see exhibits ED-SP-1 and ED-SP-4 for a more

The Application shows a combined equity amount of \$1,687,543 for water and sewer,¹¹¹ which becomes \$1,486,484 when the note payable to Universal Premium Acceptance Corporation is removed. Staff proposes a negative equity amount of -\$297,564.42 for water service, arrived at by subtracting water's total debt of \$743,242 from total invested capital of \$445,678.¹¹² Based on this negative equity amount, the federal income tax for the water portion of the utility would be reduced from \$34,758 to \$0.¹¹³

Staff proposes increasing the federal income tax for wastewater by \$10,544, from Decker's proposed amount of \$72,753 to \$83,296.62. The Application indicates an equity amount of \$1,687,543 for wastewater,¹¹⁴ which becomes \$1,486,484 when the note payable to Universal Premium Acceptance Corporation is removed. Staff calculated an equity amount for wastewater of \$1,443,610 by subtracting Decker's total debt from the utility's total invested capital for sewer service ($\$2,186,852 - \$743,242 = \$1,443,610$).¹¹⁵

detailed calculation of income taxes related to water service; *see* exhibits ED-SP-5 and ED-SP-8 for a more detailed calculation of income taxes related to wastewater service.

¹¹¹ Note that the Application states the \$1,687,543 calculation for equity combines water and sewer. Loockerman's pre-filed testimony, Decker Exh. 1, at 36-37 (Application, at 11-12). The amount includes a \$14,432 note payable to Universal Premium Acceptance Corporation.

¹¹² The \$743,242 is half of the Hybernia National Bank debt listed in the Long Term Debt and Equity Information part of the Application at 12 and 24. Note that Ms. Perryman moved the \$14,343 note payable to Universal Premium Acceptance Corporation to insurance costs, leaving only the Hybernia Bank debt. Also, the \$445,678 comes from adding net plant of \$427,910 and \$17,768 in working capital allowance. *See* Ms. Perryman's amended testimony, ED Exh. 1-A, at 9 and exhibit ED-SP-2.

¹¹³ Ms. Perryman's amended testimony, ED Exh. 1-A, at 8-9; *see* exhibits ED-SP-1 and ED-SP-4 for a more detailed calculation of income taxes.

¹¹⁴ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 48-49 (Application, at 23-24). Note the contradiction in the Application showing the combined equity for water and sewer to be \$1,687,543 in the water portion and part of the sewer portion of the Application (Application, at 11, 12, and 23) but to be for sewer only on one page of the sewer portion of the Application (Application, at 24). The ALJ finds evidence as a whole established the equity amount is for both water and sewer.

¹¹⁵ Ms. Perryman's amended testimony, ED Exh. 1-A, at 8-9. *See* exhibits ED-SP-5, SP-6, and ED-SP-8 for a more detailed calculation. Note that Ms. Perryman allocates half of Decker's equity of \$1,486,484 to sewer, which is why the amount subtracted is \$743,242.

5. ALJ's analysis and recommendation

a. Allowable expenses

Overall, the ALJ finds most of Ms. Loockerman's calculations for allowable expenses to be reasonable and necessary to provide service to the ratepayers. While the Commission may disallow expenses not supported by invoices, receipts, and/or check stubs, as set out in Staff's calculations, the ALJ recommends that those expenses be allowed in this case. All of Ms. Loockerman's expenses are supported either by the general ledger in combination with invoices, receipts, and/or check stubs; the general ledger alone; or known and measurable changes to test year expenses incurred between January 1, 2007 and February 1, 2008. In addition, Ms. Loockerman removed from her calculations non-utility expenses, personal expenses, and expenses she found to be unreasonable, such as the year 2007 increase in insurance cost. The ALJ recommends that Ms. Loockerman's calculations for allowable expenses be adopted by the Commission except for the following changes:

- **utility expenses.** Ms. Loockerman did not include a known and measurable increase of \$14,417 in utility expense in her calculations because she felt her charge for recalculating the cost of service would not be warranted. The ALJ finds this is a *bona fide* known and measurable expense that should be included in the cost of service.
- **repairs and maintenance expenses.** The ALJ could not determine if the invoice that was outside the test year and disallowed by Staff was also disallowed by Ms. Loockerman. If it was not disallowed in her calculations, it should be.¹¹⁶

b. Depreciation

As for depreciation, both Mr. Fenner and Mr. Mach agreed that trending analysis is more an art than a science. Mr. Fenner could not recall exactly which Handy-Whitman Index he used to perform the trending analyses for original costs of the water and sewer plants, but testified it was the

¹¹⁶ The ALJ invites the parties to address this expense in their exceptions to the Proposal for Decision.

version he had purchased in 2007; according to Mr. Mach, both of them started their calculations with the 2000 Handy-Whitman Index; but they differ as to the year 2000 replacement cost for certain items.¹¹⁷ The ALJ recommends that Mr. Fenner's calculations for depreciation be adopted by the Commission except for the following change, which will also lead to a change in net plant:

- **Man holes.** The total accumulated depreciation for man holes should be increased from \$101 to \$103,020, which changes the total depreciation for Decker's sewer plant to \$305,966.¹¹⁸

B. Return on invested capital

The return on invested capital is the rate of return times invested capital. 30 TAC § 291.31(c).

1. Rate of return

Applicable law found at 30 TAC § 291.31(c) states:

The commission shall allow each utility a reasonable opportunity to earn a reasonable rate of return, which is expressed as a percentage of invested capital, and shall fix the rate of return in accordance with the following principles.

(1)(A) The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

(1)(B) The commission shall consider the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management, along with other relevant conditions and practices.

¹¹⁷ Recording of October 14, 2008 proceeding, HOM 4 of 4, beginning at approximately 31:12 minutes.

¹¹⁸ The ALJ agrees with the ED's argument that Decker's underestimation of depreciation for man holes results in an over estimation of net book value (net plant) which results in an overestimated revenue requirement. ED's Replies to Closing Arguments, at 3.

(1)(C) The commission may, in addition, consider inflation, deflation, the growth rate of the service area, and the need for the utility to attract new capital. In each case, the commission shall consider the utility's cost of capital, which is the composite of the cost of the various classes of capital used by the utility.

(1)(C)(i) Debt capital. The cost of debt capital is the actual cost of debt. 30 TAC § 291(c)(1)(C)(i)

(1)(C)(ii) Equity capital. The cost of equity capital must be based upon a fair return on its value. . . .

a. Decker's evidence and argument

Ms. Loockerman used a weighted rate of return of 9.5557 percent for both water and sewer, because debt has not been separated into water and sewer categories by Decker.¹¹⁹ She arrived at the 9.5557 percent weighted rate of return by allowing a return of 12-percent interest on Decker's total investment/equity of \$1,687,543, weighted with 6.3514-percent interest on Decker's debt of \$1,500,826.¹²⁰ She testified that it is reasonable to use the rate of return for the utility as a whole as the rate of return for water and sewer services, because the water and sewer plant are part of one company, and debt obtained was used by both water and sewer system assets.¹²¹

Ms. Loockerman explained her choice of 12 percent for the rate of return on equity capital as reasonable, for the following reasons:¹²²

- Over the past decade and even before, a 12-percent rate of return has been consistently recommended and used by the TCEQ staff in calculating return dollars.
- The recommended 12-percent rate is substantially higher than returns for other investments,

¹¹⁹ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 37 and 49 (Application, at 12 and 24).

¹²⁰ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 37 and 49 (Application, at 12 and 24).

¹²¹ The rate base is made up primarily of net plant and equipment used and useful in providing service to the public. Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 20 and 22.

¹²² Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 21. *See also* Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 37 and 49 (Application, at 12 and 24).

because small water utilities in Texas are considered high-risk operations. They are subject to a high level of regulation, variations in water supply (rainfall and the quality of water obtained from various sources), and generally a small number of connections over which to spread costs. They are subject to weather conditions such as hurricanes and lightning strikes. Their rates are determined based on what the TCEQ believes to be reasonable and necessary.

- Generally, for a utility of Decker's size, it is difficult to borrow funds using only investor-owned utility assets, and normally the owner must personally sign for utility debt, putting his personal assets at risk if the utility should fail.

To calculate return, Ms. Loockerman started with a net book value (total debt and equity) of \$3,188,369.¹²³ When net book value is multiplied by 9.5557 percent, the result is a return of \$308,509. Ms. Loockerman allocated 18 percent of the return, or \$55,532, to water and 82 percent of the return, or \$252,977, to sewer. She used the following calculations to arrive at the allocation percentages:

- When net water plant of \$564,076 is divided by total net plant of \$3,188,269, the quotient is 18 percent. The result of multiplying the total return of \$308,509 times 18 percent is \$55,532.¹²⁴
- When net sewer plant of \$2,624,293 is divided by total plant of \$3,188,369, the quotient is 82 percent. The result of multiplying the total return of \$308,509 times 82 percent is \$252,977.¹²⁵

¹²³ In her pre-filed testimony, Ms. Loockerman uses \$3,228,544, but in her calculations, she uses \$3,188,369. See Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 21, compared to her calculations at Decker Exh. 1, at 38 and 50 (Application, at 13 and 25). The discrepancy was not addressed at hearing; the ALJ finds \$3,188,369 to be correct (\$1,687,543 in equity plus \$1,500,826 in debt equals \$3,188,369).

¹²⁴ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 38, 50, and 83 (Application, at 13, 25, and Attachment C).

¹²⁵ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 38, 50, and 84 (Application at 13, 25, and Attachment C).

- i. **Decker's efforts and achievements regarding conservation of resources, quality of service, efficiency of operations, and quality of management**¹²⁶

Conservation of resources

Mr. Weedn said that to minimize the cost of water and sewer service, Decker does as much in-house as possible to avoid using expensive contractors. The utility buys in bulk, when that option is available, and at the best price possible. Mr. Weedn insures expenditures are necessary.¹²⁷

Quality of service

Mr. Fenner inspected Decker's water facilities and found them to be in good condition, well maintained, and in compliance with the minimum water system capacity requirements found at 30 TAC § 290.45. Mr. Fenner found the sewer facilities to be in "fairly good condition," noting that an intruder resistant fence and sound insulation for the blower that were needed at the time of inspection have since been added. The sewer facilities meet applicable wastewater treatment requirements.¹²⁸

Decker has been under a sewer enforcement action by the TCEQ primarily related to past effluent permit violations that are resolved now that the new WWTP is on line and in balanced commercial operation. Decker has been cited for treating third-party waste from port-o-potties without the proper TDPES permit. When instructed by the TCEQ that there was a technical difference between port-o-potty waste and waste received through pipes, Mr. Weedn immediately started the process to apply for an industrial wastewater permit as an additional permit to the WWTP.¹²⁹

¹²⁶ See 30 TAC § 291(c)(1)(B).

¹²⁷ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 11.

¹²⁸ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 5-6.

¹²⁹ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 9.

According to Mr. Powell, two or three monitoring-violation notices were sent out in 2006: “boil water” notices were sent out when the TCEQ reported it had not received Decker’s monthly microbial reports; once, a positive BacT sample was taken and a boil water notice was issued; finally, all local water companies issued “boil water” notices after Hurricane Rita as a precautionary measure.¹³⁰

The environmental quality investigation conducted in 2006 resulted in only one minor violation that was corrected and resolved to the TCEQ’s satisfaction.¹³¹ According to Mr. Mach, all violations contained in the TCEQ investigative reports have been resolved, except for the most recent sewer violation found on March 20, 2008, related to complying with the 150-foot buffer zone requirements pursuant to 30 TAC § 309.13(e). He said both the water and sewer system meet the TCEQ’s minimum design standards except for the 150-foot buffer zone requirement.¹³²

Efficiency of operations

Decker has two licensed plant operators on call to meet TCEQ requirements. Mr. Weedn is the chief licensed operator and Aucoin & Associates is the contracted operator. One of the operators is available 24 hours daily for emergencies such as service problems and outages.¹³³

On a daily basis, Aucoin & Associates tests the water for chlorine residual per TCEQ-prescribed protocols, Mr. Weedn said, and runs daily operational tests for sewer system compliance with TCEQ standards. The company checks the water wells and pump stations to insure that everything is operating properly. Every year TCEQ sends inspectors to perform detailed inspections of the system. TCEQ staff take water samples annually to be tested at Decker’s expense at state-

¹³⁰ Mr. Powell’s pre-filed testimony, Decker Exh. 4, at 11. The ALJ notes that Hurricane Rita occurred in 2005, not in 2006.

¹³¹ Mr. Fenner’s pre-filed testimony, Decker Exh. 2, at 5 and 6. *See also* 30 TAC § 291(c)(1)(B).

¹³² Mr. Mach’s amended testimony, ED Exh. 2-A, at 5.

¹³³ Mr. Powell’s pre-filed testimony, Decker Exh. 4, at 10; Mr. Weedn’s pre-filed testimony, Decker Exh. 3, at 8

approved labs and conduct periodic inspections and tests. Personnel from state-approved labs come by monthly, or more often if necessary, to take samples of treated effluent for independent testing.¹³⁴ Mr. Weedn himself makes periodic inspections of the water and sewer system.¹³⁵

Quality of management

Mr. Weedn said that during the test year and to date, he usually spent more than 40 hours per week actively working on Decker-related business.¹³⁶ Currently, he is not selling new homes or developing new subdivisions, and both Decker and Mr. Weedn personally are in bankruptcy. He considers bankruptcy work related to Decker to be utility business as part of the necessary management of a company required to continue to operate under state-issued licenses and permits.¹³⁷

Mr. Weedn said customer service and utility service billing was formerly under the control of his estranged wife, Susie Weedn. He said he recently learned that Ms. Weedn did not always follow the TCEQ rules when applying tariffs or when dealing with customers. Ms. Weedn is now barred by court order from the Decker office and these areas are now managed by Mr. Powell and Leigh Ann Johnson, customer service manager.¹³⁸

Mr. Powell, Decker's office manager, stated that staff in charge of security deposit transactions is familiar with the regulations regarding handling and maintaining these funds, and interest has been applied to all qualifying deposit refunds since September 2007. He said his predecessor, Ms. Weedn, did not comply with all of the TCEQ regulations for security deposits.¹³⁹

¹³⁴ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 8-9.

¹³⁵ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 8.

¹³⁶ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 3.

¹³⁷ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 4.

¹³⁸ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 10.

¹³⁹ Mr. Powell's pre-filed testimony, Decker Exh. 4, at 4; *see* 30 TAC § 291(c)(1)(B)

Mr. Powell said he and Ms. Johnson try to follow the TCEQ rules exactly as written.¹⁴⁰ Mr. Weedn said Decker employees are authorized to contact Mr. Zeppa for interpretation of TCEQ rules and their application to specific situations to ensure Decker is in compliance.¹⁴¹ For instance, after hearing billing complaints at the preliminary hearing in this proceeding, Decker's staff reviewed its billing practices with Mr. Zeppa and now correctly apply the tariffs that were incorrectly applied by Ms. Weedn, Mr. Powell said. He also noted that no customer bills were processed using estimates, as opposed to meter readings, in the 2006 test year.¹⁴²

b. ED's evidence and argument

Ms. Perryman recommends a return of 3.2447 percent on invested capital for the water plant, and a return of 10.2157 percent on capital invested for the sewer plant.¹⁴³ Staff used the weighted average cost of capital total as its recommended rate of return.¹⁴⁴ Ms. Perryman said the weighted cost of capital is an appropriate method to be used to derive a fair rate of return for a utility such as Decker which has both debt and equity capital. She said the return must be fair and reasonable, and should be consistent with the returns available from other investments of similar risk.¹⁴⁵

¹⁴⁰ Mr. Powell's pre-filed testimony, Decker Exh. 4, at 6.

¹⁴¹ Mr. Weedn's pre-filed testimony, Decker Exh. 3, at 11.

¹⁴² Mr. Powell's pre-filed testimony, Decker Exh. 4, at 7.

¹⁴³ Ms. Perryman's amended testimony, Decker Exh. 1-A, at 9.

¹⁴⁴ Ms. Perryman's amended testimony, Decker Exh. 1-A, at exhibits ED-SP-2 and ED-SP-6.

¹⁴⁵ Ms. Perryman's amended testimony, ED Exh. 1-A, at 10.

Staff arrived at the weighted cost of capital for water as set out in Schedule I(d) at ED-SP-2:

Payee	Principal	Interest Rate	Percentage	Weighted Avg.
Hybernia National Bank	\$743,242	6.75%	166.77%	11.26%
Universal Premium Acceptance Corporation	\$ 0	0%	0%	0%
EQUITY	-\$297,564.42	12.00%	-66.77%	-8.01%
TOTAL	\$445,677.58		100.00%	3.2447%

For water, Staff proposes to reduce Decker's proposed return of \$55,532 on net invested capital by \$41,071. Staff calculated its recommended return of \$14,461 by adding the net plant of \$427,910 plus working capital allowance of \$17,768, a total of \$445,678, and multiplying that sum times 3.2447 percent.¹⁴⁶

Staff's calculations for its rate of return for sewer are set out in ED-SP-6:

Payee	Principal	Interest Rate	Percentage	Weighted Avg.
Hybernia National Bank	\$743,242	6.75%	33.99%	2.29%
Universal Premium Acceptance Corp.	\$ 0	12.74% [sic]	0.00%	0.00%
EQUITY	\$1,443,610.01	12.00%	66.01%	7.92%
TOTAL	\$2,186,852.01		100.00%	10.2157%

¹⁴⁶ $(\$427,910 + \$17,768) \times 3.2447 \text{ percent} = \$14,461$. Ms. Perryman's amended testimony, ED Exh. 1-A, at 9-10. See Exh. ED-SP-2 and ED-SP-3 for a more detailed calculation of the return on net invested capital for water service.

For sewer, Staff proposes to reduce return Decker's proposed \$252,977 return on net invested capital by \$29,575, down to \$223,402. Ms. Perryman calculated Staff's recommended return on invested capital for wastewater by multiplying a rate of return of 10.2157 percent times total invested capital of \$2,186,852 (net plant of \$2,167,120 plus working capital allowance of \$19,732¹⁴⁷) to arrive at \$223,402.¹⁴⁸

2. Invested capital, also referred to as rate base

As set out in 30 TAC § 291.31(c)(2), the rate of return is applied to the rate base. Under 30 TAC § 291.31, components to be included in determining the rate base are:

(c)(2)(A) original cost, less accumulated depreciation, of utility plant, property, and equipment used by and useful to the utility in providing service:

(c)(2)(A)(i) original cost is the actual money cost, or the actual money value of any consideration paid other than money, of the property at the time it was dedicated to public use, whether by the utility that is the present owner or a predecessor;

(c)(2)(A)(ii) reserve for depreciation is the accumulation of recognized allocations of original cost, representing recovery of initial investment, over the estimated useful life of the asset. Depreciation must be computed on a straight line basis over the expected useful life of the item or facility;

(c)(2)(B) working capital allowance to be composed of, but not limited to, the following:

¹⁴⁷ Ms. Perryman calculated the working capital allowance based on the Commission rule found at 30 TAC § 291.31(c)(2)(B)(iii), which states working capital allowance is computed as one-eighth of operation and maintenance expenses. The rule states the return on invested capital is the rate of return times invested capital. The rate of return is applied to the rate base. Components to be included in the rate base are as follows: ... working capital allowance to be composed of, but not limited to, the following: ... a reasonable allowance up to one-eighth of total annual operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, and prepayments (operations and maintenance expense does not include depreciation, other taxes, or federal income taxes). Ms. Perryman's amended testimony, ED Exh. 1-A, at 9-10. See exhibits ED-SP-2 and ED-SP-6.

¹⁴⁸ Ms. Perryman's amended testimony, ED Exh. 1-A, at 9. See exhibits ED-SP-6 and ED-SP-7 for a more detailed calculation of the return on net invested capital for sewer service.

(c)(2)(B)(i) reasonable inventories of materials and supplies, held specifically for purposes of permitting efficient operation of the utility in providing normal utility service;

(c)(2)(B)(ii) reasonable prepayments for operating expenses (prepayment to affiliated interests) are subject to the standards set forth in TEX. WATER CODE ANN. § 13.185(e); and

(c)(2)(B)(iii) a reasonable allowance for up to one-eighth of total annual operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, and prepayments (operations and maintenance expense does not include depreciation, other taxes, or federal income taxes).

a. Decker's evidence and argument

Mr. Fenner defined net book value as the value of the useful life of the plant calculated from the original installed cost of all plant items minus the total accumulated depreciation. Net book value is used to establish the rate base and provides an investor-owned utility, such as Decker, an opportunity to earn a return on its invested capital.¹⁴⁹

For the water plant, Mr. Fenner recommended an original cost of \$669,258; annual depreciation of \$20,255; accumulated depreciation of \$105,182; and net book value of \$564,076. For the sewer facilities, Mr. Fenner recommended an original cost of \$2,827,441; annual depreciation of \$57,018; corrected accumulated depreciation of \$305,966; and net book value of \$2,624,293.¹⁵⁰

¹⁴⁹ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 6-7. Exhibit BWF-1 summarizes Mr. Fenner's water plant and equipment calculations; exhibit BWF-2 summarizes his sewer plant and equipment calculations. Note that the total accumulated depreciation in BWF-2 should be \$305,966, to reflect the change made following Mr. Fenner's testimony regarding the total accumulated depreciation for man holes. Recording of October 14, 2008 proceeding, beginning at approximately 1:50:01 hours in segment HOM 1 of 4.

¹⁵⁰ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 7.

b. ED's evidence and argument

For water plant, Mr. Mach calculated an original cost of \$516,259; annual depreciation of \$15,983; accumulated depreciation of \$83,350; and a net value of \$427,910.¹⁵¹

Mr. Mach's calculated original cost of the sewer plant is \$2,404,722; annual depreciation is \$48,546; accumulated depreciation is \$237,601; and net value is \$2,167,120.¹⁵²

3. ALJ's analysis and recommendation

Both Decker and the ED recommended a 12 percent rate of return on invested capital, a rate the ALJ finds to be reasonable based on Ms. Loockerman's testimony regarding the investment risk associated with small Texas utilities. Over all, the ALJ finds Ms. Loockerman's calculations for return on invested capital to be reasonable and necessary, except for the following changes:

- **rate of return.** The Universal Premium Acceptance Corporation expense of \$14,342 should be removed from Decker's debt, as recommended by Staff, leaving only the \$1,486,484 loan payable to Hybernia National Bank at 6.75 percent interest. According to Ms. Perryman's testimony, the \$14,342 was already counted as part of Decker's insurance expense, so Ms. Loockerman's proposed insurance expense need not be adjusted. The Long Term Debt and Equity Information for water and sewer as contained in Section IV-Water and Section IV-Sewer of the Application should be recalculated accordingly.
- **rate base.** Net book value, return, and the percentage of return allocated to water and sewer should be adjusted to reflect the aforementioned change in rate of return.

The ALJ does not recommend Staff's proposed rate of return primarily because the allocation of the Hybernia National Bank debt equally between water and sewer based on number of connections results in negative equity for water, which does not accurately reflect Decker's capital

¹⁵¹ Mr. Mach's amended testimony, ED Exh. 2-A, at 7; *see* exhibits ED-KM-1 and ED-KM-1a for comparison purposes.

¹⁵² Mr. Mach's amended testimony, ED Exh. 2-A, at 7-8; *see* exhibits ED-KM-2 and ED-KM-2a for comparison

investment in its water plant or how the loan proceeds were used. Testimony established that the money was borrowed to expand the wastewater treatment plant in 2005.

The ALJ finds that either allocating all of the debt to sewer in determining rate of return, or at the very least pro-rating the debt between water and sewer based on the respective invested capital for each, would result in a more reasonable rate of return. Staff's total invested capital for water and sewer totals \$2,632,530.¹⁵³ Using Staff's total invested capital of \$445,677 for water and \$2,186,852 for sewer, the pro-rated percentages of total invested capital are 17 percent for water and 83 percent for sewer. These percentages are very close to Decker's pro-rated percentages of 18 percent for water and 82 percent for sewer, and would result in a rate of return that is more fair and reasonable than Staff's recommended 3.2447 percent return for water and 10.2157 percent return for sewer.

V. RATE DESIGN

As set out in 30 TAC § 291.32(a), in fixing the rates of a utility, the Commission shall fix its overall revenues at a level which will (1) permit such utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public, over and above its reasonable and necessary operating expenses. . . and (2) preserve the financial integrity of the utility.

Note that the water and sewer tariffs submitted in the Application comply with 30 TAC ch. 291.¹⁵⁴

purposes.

¹⁵³ Ms. Perryman's testimony, ED Exh. 1-A, at exhibits ED-SP-2 and ED-SP-6.

¹⁵⁴ Mr. Mach's amended testimony, ED Exh. 2-A, at 9.

The proposed rates listed in the Application are as follow:¹⁵⁵

Water

Minimum Bill

5/8" or 3/4"	\$25.88
1"	\$64.70
1 1/2"	\$129.40
2"	\$207.04
3"	\$388.20
4"	\$517.60
6"	\$569.36

Gallonage Rate

\$2.29 for each 1,000 gallons
over the minimum

Sewer

Minimum Bill

5/8" or 3/4"	\$64.67
1"	\$64.67
1 1/2"	\$64.67
2"	\$64.67
3"	\$64.67
4"	\$64.67
6"	\$64.67

Gallonage Rate

\$4.00 for each 1,000 gallons
over the minimum

A. Decker's evidence and argument

Mr. Fenner's proposed water rates are based on a water revenue requirement of \$269,120 and a sewer revenue requirement of \$558,123 as recommended by Ms. Loockerman.¹⁵⁶ Mr. Fenner makes the following changes to the rates proposed in the Application, adopting the meter equivalent multipliers recommended by Mr. Mach for 4" and 6" connections [changes are highlighted in bold, italic type].¹⁵⁷

¹⁵⁵ Ms. Loockerman's pre-filed testimony, at 58-61 (Application, at 33-36).

¹⁵⁶ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 9. See also exhibits BWF-4 and BWF-5.

¹⁵⁷ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 8-9. Recording of October 14, 2008 proceeding, beginning at approximately 1:51:52 hours in segment HOM 1 of 1.

Water

Minimum Bill

5/8" or 3/4"	\$25.88
1"	\$64.70
1 1/2"	\$129.40
2"	\$207.04
3"	\$388.20
4"	\$647.00
6"	\$1,294.00

Gallonage Rate

\$2.29 for each 1,000 gallons over the minimum, with zero gallons included in the minimum bill.

Sewer

Minimum Bill

5/8" or 3/4"	\$64.67
1"	\$64.67
1 1/2"	\$64.67
2"	\$64.67
3"	\$64.67
4"	\$64.67
6"	\$64.67

Gallonage Rate

\$4.00 for each 1,000 gallons over the minimum, with zero gallons included in the minimum bill.¹⁵⁸

Mr. Fenner testified that when he changed the equivalency factor, he did not change the customer equivalents for the 2006 test year. He agreed that Mr. Mach's calculation of 641.5 customer or meter equivalents for water would be more representative of the correct number for Decker than the 613.5 customer or meter equivalents he used. He also stated that increasing the customer or meter equivalents from the 613.5 he used to the 641.5 recommended by Mr. Mach would result in a decrease in his water rate design.¹⁵⁹

¹⁵⁸ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 9.

¹⁵⁹ Recording of October 14, 2008 proceeding, beginning at approximately 01:51:52 hours in segment HOM 1 of 1. See also Fenner's pre-filed testimony, Decker Exh. 2, at 8-9, and exhibit BWF-4.

B. ED's evidence and argument

For his rate design, Mr. Mach used annual revenue requirements of \$181,444 for water and \$523,042 for sewer as calculated by Ms. Perryman.¹⁶⁰ He said that based on a rate design using Staff's recommended revenue requirement, Decker cannot justify a water rate increase.¹⁶¹

The ED's proposed rates, which reflect no change to Decker's existing water rates, are set out below:¹⁶²

Water

Sewer

Minimum Bill

Minimum Bill

5/8" or 3/4"	\$19.70
1"	\$32.90
1 1/2"	\$65.60
2"	\$105.00
3"	\$197.00
4"	\$328.40
6"	NA

5/8" or 3/4"	\$59.28
1"	\$59.28
1 1/2"	\$59.28
2"	\$59.28
3"	\$59.28
4"	\$59.28
6"	\$59.28

Gallage Rate

\$1.15 for each 1,000 gallons
over the minimum¹⁶³

Gallage Rate

\$4.00 for each 1,000 gallons
over the minimum based on winter month
average of water consumption¹⁶⁴

¹⁶⁰ Ms. Perryman's amended testimony, ED Exh. 1-A, at 11. See Ms. Perryman's amended testimony, Ed Exh. 1-A, exhibits ED-SP-3, column e, and ED-SP-7, column e, for more information.

¹⁶¹ Mr. Fenner's amended testimony, ED Exh. 2-A, at 10.

¹⁶² Decker's rates as charged before February 1, 2008, are set out in the Ms. Loockerman's pre-filed testimony, at 60 (Application, at 35).

¹⁶³ Mr. Mach recommends that Decker keep its current rate base of \$19.70 per month for a 5/8" or 3/4" size meter connection, and a gallage rate of \$1.15 per 1,000 gallons. Mr. Mach's amended testimony, ED Exh. 2-A, at 10. But note this recommendation differs from the figures contained in exhibit ED-KM-5 attached to his testimony.

¹⁶⁴ Mr. Mach's amended testimony, ED Exh. 2-A, at 10-11. Mr. Mach recommends winter month average consumption for sewer gallage because water usage activities during fall, summer, and spring can be indoor or outdoor. Outdoor water usage activities such as irrigating or gardening do not transport wastewater to the sewer plant. During December, January, and February, most water usage is indoors, resulting in wastewater transporting to the sewer plant for treatment. Therefore, Mr. Mach recommends Decker use the winter month average to better reflect the

As is typically done by the TCEQ in calculating meter equivalents for water, Mr. Mach used the equivalent factors for the different sizes of meters from the American Water Works Association (AWWA), which is the ratio of rated meter capacity for each meter size relative to a 5/8" or 3/4" meter. The base rate calculated for a 5/8" or 3/4" meter multiplied by the respective equivalent factor of the particular size meter will result in the base rate for that size meter. For example, the equivalent factor for a 1" meter is 2.5. So, the base rate for a 1" meter will be the base rate of a 5/8" or 3/4" meter multiplied by 2.5. In accordance with the AWWA Manual M6 (1972, second edition), Mr. Mach used a meter equivalency factor of 50 for a 6" meter instead of a factor of 22 as listed in the Application.

Mr. Mach recommends using 641.5 equivalent active water connections for water rate design, instead of the 542 connections listed in the Application. He recommends using 542 sewer connections for water rate design, which is the number of active sewer connections listed in the Application.¹⁶⁵

Mr. Mach attempted to analyze the possibility of excessive line loss, but the Application did not list the number of gallons pumped during the test year for him to compare with the 34,374,080 gallons that were billed to customers that year. Mr. Mach contacted the Lone Star Groundwater Conservation District (LSGCD), and found Decker had reported to the LSGCD that it had pumped 31,541,657 gallons of water during the test year, which is less than the number of gallons billed to customers. Mr. Mach said based on that information, he had to assume line loss is minimal. He used 34,374,080 gallons—the amount billed to ratepayers—in his rate design.¹⁶⁶

ratepayers' actual flow of wastewater to the sewer plant. *See also* Mr. Mach's amended testimony, ED Exh. 2-A, exhibit ED-KM-6.

¹⁶⁵ Table 2.2 in Water Meters of AWWA Manual M6 second edition shows a 5/8" displacement meter at 20 gallons per minute (gpm) maximum rate capacity and a 6" displacement meter at 1,000 gpm maximum rate capacity. The ratio of 1,000 gpm to 20 gpm yields a meter equivalency factor of 50. *See* Mr. Mach's amended testimony, ED Exh. 2-A, at 9-10.

¹⁶⁶ Mr. Mach's amended testimony, Exh. 2-A, at 6; *see* exhibits ED-KM-3 for water and ED-KM-4 for sewer.

C. ALJ's Analysis and Recommendation

The evidence establishes that for water rates, a customer or meter equivalent factor of 641.5, as calculated by Mr. Mach and agreed to by Mr. Fenner, should be used instead of the 613.5 customer or meter equivalent used in establishing Decker's proposed rates.¹⁶⁷ The ALJ recommends that Decker's modified proposed water rates, as prepared by Mr. Fenner and set out in his pre-filed testimony,¹⁶⁸ be further modified to reflect a customer or meter equivalent of 641.5.

VI. ALJ'S CONCLUSION

In summary, the revised proposed rates should reflect:

- a known and measurable increase of \$14,417 in utility expenses;
- exclusion of the expense associated with the invoice outside the test year;
- a correction to Mr. Fenner's accumulated depreciation for man holes;
- a recalculation of long term debt and equity information after the Universal Premium Acceptance Corporation expense of \$14,342 is removed from loans payable;
- adjustments to net book value, return, and percentage of return allocated to water and sewer, using Ms. Loockerman's method, after rate of return is recalculated;
- and an adjustment to Mr. Fenner's design for water rates, using 641.5 meter equivalents.

The evidence in the record is sufficient to allow a recalculation of Decker's costs of service, invested capital, return, and rates based on the ALJ's recommendations. However, the ALJ could easily make a mathematical error. For that reason, the ALJ asks the ED to make the appropriate

¹⁶⁷ See Mr. Fenner's pre-filed testimony, Decker Exh. 2, at exhibit BWF-4.

¹⁶⁸ Mr. Fenner's pre-filed testimony, Decker Exh. 2, at 9.

recalculations based on the ALJ's recommendations and to include those along with the ED's exceptions to this Proposal for Decision.

Decker should refund any over recovery of rates that occurred during the pendency of this rate proceeding at 1.17 percent interest as a credit on customer's bills over a two-year period; customers who no longer receive service from Decker should receive a direct refund for the amount of over collection.¹⁶⁹

VII. CURRENT RATE CASE EXPENSES

As set out in 30 TAC § 291.28(7), a utility may recover rate case expenses, including attorney fees, incurred as a result of a rate change application only if the expenses are reasonable, necessary, and in the public interest. Under 30 TAC § 291.31(b)(2)(I), any expenditure found by the Commission to be unreasonable, unnecessary, or not in the public interest, including rate case expenses, may be disallowed as a component of cost of service.

Decker seeks to recover \$31,197.23 in estimated rate-case expenses associated with this proceeding, in addition to the \$3,250 associated with filing the Application before the proposed rates were challenged. The \$3,250 is included in Decker's proposed cost of service.¹⁷⁰

¹⁶⁹ Ms. Perryman's amended testimony, ED Exh. 1-A, at 11. The 1.17 percent interest rate is set by the Public Utility Commission of Texas in 2004 for overbillings and underbillings. See Exh. EDSP-17, "Historical Record of Interest Rates Set by the Public Utility Commission, PUC" and 16 TAC § 25.28(c) (3)(A).

¹⁷⁰ Ms. Loockerman included the \$3,250 of rate case expense associated with filing the Application in the revenue requirement, because rate case expense is part of the normal operating expense for any regulated utility. Decker paid the Application fee out of normal operating funds, using working capital. If the \$3,250 is removed from normal operations, Decker would not be allowed working capital acknowledgement for this expense. Ms. Loockerman recommends that the Application filing expense of \$3,250 be amortized over two years in the cost of service, and any additionally incurred rate case expense due to the evidentiary proceedings be amortized over two years as a surcharge added to customers' monthly bills upon presentation of invoices and estimated completion costs. Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 16-17.

Staff asserts that the \$800 included in Decker's rate case expense to pay for motions for rehearing should not be recovered.¹⁷¹ Staff argues that although not specifically prohibited by rule or statute, allowing the recovery of costs associated with motions for rehearing assumes that Decker did not meet its burden to show that the requested rates are just and reasonable and thus did not prevail in the contested case hearing. Forcing customers to pay additional expenses in situations where the applicant has failed to meet its burden is not in the public interest. Additionally, Staff argues, allowing recovery of expenses attributed to a motion for rehearing would require the Commission to issue an order containing speculative costs associated with the preparation of such a motion. There would be no verification of the amount of time associated with the preparation of the motion or any other associated expenses. This in turn could call in to question the validity, finality, and enforceability of the order. Allowing for recovery of these costs would also open the door for applicants to abuse the system by collecting money for a cost that may or may not be incurred. Moreover, allowing an applicant to recover expenses for the preparation of a motion for rehearing is contrary to the procedural processes applicable in a contested case hearing to ensure that only the reasonable and necessary expenses are recovered.¹⁷² The ALJ agrees with Staff that Decker's inclusion of anticipated costs of \$800 for motions for rehearing is improper, not in the public interest, against TCEQ rules and the Texas Water Code, and should be denied. Accordingly, the ALJ finds that Decker's requested rate case expense should be reduced by \$800, from \$30,197.23 to \$29,397.23.

In addition, Staff points out that Protestants submitted written settlement offers to Decker on October 14, 2008, and October 20, 2008, and both offers were rejected.¹⁷³ Under 30 TAC § 291.28(9), a utility may not recover any rate case expenses incurred after the date of a written settlement offer by all ratepayer parties if the revenue generated by the just and reasonable rate determined by the commission after a contested case hearing is less than or equal to the revenue that

¹⁷¹ ED's Replies to Closing Arguments, at 11-12

¹⁷² Staff cites TEX. WATER CODE ANN. § 13.187(c) and 30 TAC § 291.28(4). ED's Replies to Closing Arguments, at 11.

¹⁷³ ED's Replies to Closing Arguments, at 11.

would have been generated by the rate contained in the written settlement offer. The ALJ, appropriately, is unaware of the content of the written settlement offers, so cannot determine whether the requirements of 30 TAC § 291.28(9) will be met if the rates recommended in this Proposal for Decision are approved by the Commission. However, the ALJ agrees with Staff that if the Commission adopts rates that will generate revenue less than or equal to the amount that would have been generated by the rates contained in Protestants' settlement offers, the rate case expenses incurred after October 20, 2008, should be denied. The parties should address the issue further in their exceptions.

VIII. CONCLUSION

Decker's proposed rates, as reflected in the Rate/Tariff Change Application filed with the TCEQ on November 15, 2007, are reasonable and necessary to provide water and sewer service to the ratepayers, with modifications as set out in this Proposal for Decision. Further, Decker has proved that it should recover \$29,397.23 in rate case expenses.

The ALJ has attached a draft Proposed Order, which she will revise to reflect the calculations based on the ALJ's specific recommendations that the ED will provide in his exceptions.

SIGNED March 12, 2009.



SHARON CLONINGER
ADMINISTRATIVE LAW JUDGE
STATE OFFICE OF ADMINISTRATIVE HEARINGS

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



**AN ORDER Approving the Application of
HHJ, Inc. d/b/a Decker Utilities to Change Water and Sewer Rates;
TCEQ Docket No. 2008-0164-UCR;
SOAH Docket No. 582-08-1719**

On _____, the Texas Commission on Environmental Quality (Commission) considered the application of HHJ, Inc. d/b/a Decker Utilities for water and sewer rate/tariff change and for recovery of rate case expenses through imposition of a surcharge on water and sewer customers. Administrative Law Judge (ALJ) Sharon Cloninger of the State Office of Administrative Hearings (SOAH) presented a Proposal for Decision (PFD) recommending that the Commission approve the requested rate changes, with modifications. After considering the PFD, the Commission adopts the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

General and Procedural Findings

1. HHJ, Inc. d/b/a Decker Utilities (Applicant) holds Water Certificate of Convenience and Necessity (CCN) No. 12841 and Sewer CCN No. 20833.
2. On November 15, 2007, Applicant submitted to the Texas Commission on Environmental Quality (Commission) its application for water and sewer rate/tariff changes for CCN Nos. 12841 and 20833 (the Application), for its integrated utility system located in Montgomery County, Texas.

3. Applicant seeks an increase in revenues for water service in the amount of \$351,760.
4. Under the Application, the proposed rate increases were effective as of February 1, 2008.
5. Applicant timely provided notice of the proposed rate changes to its ratepayers and affected persons.
6. Within 60 days of the effective date of the proposed rate changes, at least 10 percent of Applicant's customers filed protests to the rate changes.
7. On January 31, 2008, the Commission referred the Application to the State Office of Administrative Hearings (SOAH) for a contested case hearing.
8. On March 29, 2008, notice of the hearing in this docket was provided to all affected persons.
9. On April 15, 2008, a preliminary hearing convened in this docket, at which time jurisdiction was taken and the following parties were admitted and designated: Applicant; the Executive Director (ED) of the Commission; the Office of Public Interest Counsel (OPIC); and Angela Arndt, Todd Arndt, Douglas Mendez, Stacy McCoy-Moquin, Richard Muse, and Larry Osborne (collectively, Protestants).
10. A hearing on the merits of the Application was held on October 14, 2008, at the SOAH field office in Houston, Texas. Applicant appeared through its attorney, Mark H. Zeppa; the ED appeared through Erin Selvera and Trey Jackson, staff attorneys; OPIC appeared through Christina Mann, staff attorney; and Protestants appeared through their representatives Ms. McCoy-Moquin and Mr. Osborne. The hearing recessed for the parties to negotiate a settlement. After the parties were unable to reach a settlement, the hearing reconvened on November 6, 2008, in Austin, Texas, with all parties participating in the proceeding.
11. The record closed on January 12, 2009, after the parties submitted written closing arguments.

12. During the test year, which ran from January 1-December 31, 2006, Applicant provided water and sewer service to 542 connections.
13. Applicant requested by its Application the following rates, which it implemented on February 1, 2008:

Water

Sewer

Minimum Bill

Minimum Bill

5/8" or 3/4"	\$25.88
1"	\$64.70
1 1/2"	\$129.40
2"	\$207.04
3"	\$388.20
4"	\$517.60
6"	\$569.36

5/8" or 3/4"	\$64.67
1"	\$64.67
1 1/2"	\$64.67
2"	\$64.67
3"	\$64.67
4"	\$64.67
6"	\$64.67

Gallonage Rate

\$2.29 for each 1,000 gallons over the minimum

Gallonage Rate

\$4.00 for each 1,000 gallons over the minimum

Salary and Wage Expenses

14. Applicant's reasonable and necessary salary and wage expenses are \$146,000 for providing water and sewer service.
- Applicant's utility, which has 542 connections each for water and sewer, requires at least two office personnel, two certified operators, and one plant superintendent to provide adequate service to its customers.
 - Salaries and wages of \$104,000 annually are required to pay Applicant's two office personnel and plant superintendent.
 - A salary of \$42,000 annually is required to pay Robert Weedn, Applicant's owner and manager, and one of its certified operators.

Contract Labor Expenses

15. During the test year, Applicant incurred \$4,800 in miscellaneous contract labor, mainly for office and clerical work; after the test year, Applicant hired a second certified operator, as required for a utility of Applicant's size, at a cost of \$21,600 per year.
16. The aforementioned contract labor expenses incurred during the test year and after as known and measurable changes were reasonable, necessary, and typical.

Repair and Maintenance Expenses

17. During the test year, Applicant's repair and maintenance expenses used in the determination of its rate request were actually incurred, were reasonable, and were typical of the types of repair and maintenance needs occurring regularly.

Office Expenses

18. In calculating the rates sought in this proceeding, Applicant determined that it has total rent expenses (included within office expenses) of \$7,788 per year, which is split equally between the water and sewer systems. This amount accurately reflects Applicant's reasonable and necessary rent expenses.
19. Applicant's calculated office expenses (which include rent expenses) of \$24,717 are reasonable and necessary for Applicant to provide service to its customers.

Legal and Accounting Expenses

20. Applicant's insurance expense of \$18,741 is reasonable and necessary to provide water and sewer service to its customers.
21. Applicant's legal and accounting expenses of \$9,071 normalized over the test year and 2007 are reasonable and necessary for Applicant to provide service to its customers.

Insurance Expenses

22. Applicant's insurance expenses of \$14,432 counted as a note payable to Universal Premium Acceptance Corporation should be deleted from the debt portion of the Application, and counted only as part of insurance expenses.

Utility Expenses

23. Applicant's \$46,280 test year expenses for utilities, including electricity, was reasonable and necessary to provide water and sewer service.
24. Applicant's known and measurable change of an increase of \$14,417 in utility expenses should be included in the cost of service, and allocated between water and sewer equally for office utility bills, but directly to water or sewer for bills related only to the water plant, the sewer plant, and the lift stations.

Rate Case Expenses

25. Applicant incurred reasonable and necessary rate case expenses in this matter in the amount of \$29,397.23 for preparation of the Application, including deriving the original plant and equipment costs, developing the proposed rate/tariff changes, filing fees, notice costs, and participation by experts and counsel in the contested case hearing.
26. Rate case expenses in this case were not a normal, recurring expense of operation.

Net Invested Capital

27. The Application shows Applicant's the net book value for its plant and equipment is \$564,076 for the water system and \$2,624,293 for the sewer system. These amounts do not accurately reflect the correct net book values for Applicant's plant and equipment.

28. Original plant and equipment costs were derived from a combination of historic data and application of trending analysis.
29. The correct net book value for Applicant's plant and equipment is \$564,076 for the water system, but the sewer system net book value should be adjusted based on total accumulated depreciation of \$305,966 for man holes rather than \$101 as used to arrive at the \$2,624,293 figure.

Depreciation

30. In its Applications, as revised at the hearing, Applicant determined that it had annual depreciation expense of \$9,639 for the water system and \$13,308 for the sewer system. These amounts do not accurately reflect the correct depreciation expense incurred by Applicant.
31. Applicant's reasonable and necessary annual depreciation expense for sewer should be adjusted to show total accumulated depreciation of \$305,966 for man holes rather than \$101.

Rate of Return

32. Twelve percent (12%) is a fair return on investment for Applicant to receive because it is reasonable in light of Applicant's weighted cost of capital and is consistent with the returns available from other investments of similar risk.
33. Applicant pays 6.75 percent interest on its debt to Hybernia National Bank.
34. Applicant's reasonable weighted cost of capital is _____ percent.

Rate Design

35. Applicant incorrectly used 613.5 customer or meter equivalents in its water rate design. The correct customer or meter equivalent for water rate design is 641.5.

Refunds

36. Because of the adjustments adopted by the Commission in this order, Applicant has received an over-recovery of rates (*i.e.*, overpayment by customers) during the pendency of this rate case.
37. After accounting for interest, the total refunds due to Applicant's customers for overcharges is \$ _____ for the water system and \$ _____ for the sewer system.

Miscellaneous

38. Non-rate fees and charges, and service policies in the proposed rate/tariff are consistent with Commission rules and with tariffs approved by the Commission for other similarly-situated utilities.

CONCLUSIONS OF LAW

1. Applicant is a public utility as defined in TEX. WATER CODE ANN. § 13.002(23).
2. The Texas Commission on Environmental Quality has jurisdiction to consider an application for a rate increase filed by a public utility, pursuant to TEX. WATER CODE ANN. § 13.181.
3. The ALJ conducted a contested case hearing and issued a proposal for decision on the Applicant's proposed water and sewer rate/tariff changes under TEX. GOV'T. CODE ANN. ch. 2003, TEX. WATER CODE ANN. ch. 13, and 30 TEX. ADMIN. CODE chs. 80 and 291.
4. Proper notice of the Application was given by the Applicant as required by TEX. WATER CODE ANN. § 13.187, 30 TEX. ADMIN. CODE §§ 291.22 and 291.28, and TEX. GOV'T. CODE ANN. §§ 2001.051 and 2001.052.

5. The invested capital amounts set forth in the Findings of Fact above are based on the original cost of property used by and useful to the Applicant in providing service, less depreciation, in accordance with TEX. WATER CODE ANN. § 13.185.
6. The revenue requirements are based on Applicant's reasonable and necessary operating expenses, within the meaning of TEX. WATER CODE ANN. §§ 13.183 and 13.185.
7. The revenue requirements are sufficient to provide Applicant with a reasonable opportunity to earn a fair and equitable return on its invested capital while preserving its financial integrity, within the meaning of TEX. WATER CODE ANN. §§ 13.183 and 13.184.
8. The rates and fees to be charged by Applicant, as approved by the Commission in this Order, are just and reasonable, not unreasonably preferential, prejudicial, or discriminatory, and sufficient, equitable, and consistent in application to each class of customer in accordance with TEX. WATER CODE ANN. §§ 13.182, 13.189, and 13.190.
9. Rate case expenses in the amount of \$29,397.23 were a reasonable and necessary cost within the meaning of TEX. WATER CODE ANN. § 13.185(d) and (h), and recovery of these costs through a monthly surcharge of \$ _____ per customer for two years, or until the amount is paid, complies with 30 TEX. ADMIN. CODE § 291.21(k) for collection of revenues over and above the usual cost of service.

10. The following rates are appropriate to implement the Commission's rulings in this matter:

Water

Sewer

Minimum Bill (including 0 gallons)

Minimum Bill (including 0 gallons)

5/8" x 3/4"	\$
1"	\$
1-1/2"	\$
2"	\$
3"	\$
4"	\$
6"	\$
8'	\$

5/8" x 3/4"	
1"	
1-1/2"	\$
2"	\$
3"	\$
4"	\$
6"	\$
8"	\$

Gallonge Rate

\$ _____ per each 1,000 gallons

Gallonge Rate

\$ _____ per each 1,000 gallons

11. The appropriate interest rate to be applied to overcharges collected by the Applicant during the pendency of this rate case is 1.17 percent. After accounting for interest at this rate, the total refunds due customers for overcharges is \$ _____ for the water system and \$ _____ for the sewer system.

NOW, THEREFORE, BE IT ORDERED BY THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY THAT:

1. The Application of HHJ, Inc. d/b/a Decker Utilities for water and sewer rate/tariff changes are granted as modified by, and to the extent set forth in, the above Findings of Fact and Conclusions of Law.
2. The request of HHJ, Inc. d/b/a Decker Utilities to apply a surcharge to recover rate case expenses in the amount of \$29,397.23, to be recovered as a monthly surcharge of \$ _____

to each water and sewer customer for two years or until paid, is approved. The surcharge shall be discontinued at such time as the amount of \$29,397.23 is recovered.

3. HHJ, Inc. d/b/a Decker Utilities shall refund customers, for a period of _____ months, the amount of \$ _____ per water connection per month and \$ _____ per sewer connection per month for the over-recovery of rates that occurred during the pendency of this rate proceeding. This refund shall occur in the form of a credit on customers' bills. Customers who no longer take service from HHJ, Inc. d/b/a Decker Utilities shall have the total amount of refund paid directly to them.
4. HHJ, Inc. d/b/a Decker Utilities shall file a report to the Commission's Utilities and Districts Section, Water Supply Division, demonstrating compliance with the refund requirements of this Order. This report shall be filed each quarter until such time that all overcharges have been refunded.
5. HHJ, Inc. d/b/a Decker Utilities shall file a tariff reflecting the rates approved by the Commission within 10 days of the date of this Order.
6. HHJ, Inc. d/b/a Decker Utilities shall notify customers by mail of the final rate structure within 30 days of the date of this Order and shall include the statement required by 30 TEX. ADMIN. CODE § 291.28(5) along with the first bill to customers implementing the rates approved by this Order.
7. The effective date of this Order is the date the Order is final, as provided by TEX. GOV'T CODE ANN. §2001.144 and 30 TEX. ADMIN. CODE § 80.273.

8. All other motions, requests for entry of specific Findings of Fact or Conclusions of Law, and any other requests for general or specific relief not expressly granted herein, are hereby denied for want of merit.
9. The Chief Clerk of the Texas Commission on Environmental Quality shall forward a copy of this Order and tariff to the parties.
10. If any provision, sentence, clause, or phase of this Order is for any reason held to be invalid, the invalidity of any portion shall not affect the validity of the remaining portions of the Order.

Issue Date:

TEXAS COMMISSION ON
ENVIRONMENTAL QUALITY

Buddy Garcia, Chairman

Texas Commission on Environmental Quality